

I hereby give notice that an extraordinary meeting of the Governing Body will be held on:

**Date:** Thursday, 8 February 2024  
**Time:** 11.00am or at the conclusion of the  
Transport and Infrastructure Committee  
meeting, whichever is later  
**Meeting Room:** Reception Lounge  
**Venue:** Auckland Town Hall  
301-305 Queen Street  
Auckland

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## Tira Hautū / Governing Body

### OPEN AGENDA

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#### MEMBERSHIP

<b>Mayor</b>	Wayne Brown	
<b>Deputy Mayor</b>	Cr Desley Simpson, JP	
<b>Councillors</b>	Cr Andrew Baker	Cr Mike Lee
	Cr Josephine Bartley	Cr Kerrin Leoni
	Cr Angela Dalton	Cr Daniel Newman, JP
	Cr Chris Darby	Cr Greg Sayers
	Cr Julie Fairey	Cr Sharon Stewart, QSM
	Cr Alf Filipaina, MNZM	Cr Ken Turner
	Cr Christine Fletcher, QSO	Cr Wayne Walker
	Cr Lotu Fuli	Cr John Watson
	Cr Shane Henderson	Cr Maurice Williamson
	Cr Richard Hills	

(Quorum 11 members)

**Sandra O'Toole**  
Kaiarataki Kapa Tohutohu Mana Whakahaere /  
Team Leader Governance Advisors

**2 February 2024**

Contact Telephone: (09) 890 8152  
Email: [sandra.otoole@aucklandcouncil.govt.nz](mailto:sandra.otoole@aucklandcouncil.govt.nz)  
Website: [www.aucklandcouncil.govt.nz](http://www.aucklandcouncil.govt.nz)



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**1 Ngā Tamōtanga | Apologies**

**2 Te Whakapuaki i te Whai Pānga | Declaration of Interest**

**3 Ngā Kōrero a te Marea | Public Input**

There is no public input section.

**4 Ngā Kōrero a te Poari ā-Rohe Pātata | Local Board Input**

There is no local board input section.

**5 Ngā Pakihi Autaia | Extraordinary Business**



## Budget Update Report February 2024

File No.: CP2024/00197

### Te take mō te pūrongo Purpose of the report

1. To approve an increase in available debt for Watercare for the 2023/2024 financial year of \$130 million. The increase in debt is associated with the Auckland Anniversary and Cyclone Gabrielle events of early 2023 and the Ōrākei main sewer break, timing associated with Central Interceptor cost escalation payments and additional working capital headroom.

### Whakarāpopototanga matua Executive summary

2. The Annual Plan 2023/2024 approved Watercare to borrow \$485 million. Watercare has confirmed that an additional \$130 million is required to address a timing issue in the current financial year associated with the significant unbudgeted events in the 2023 calendar year, to allow for the recently confirmed Central Interceptor escalation cost arrangement, and to provide for additional working capital requirements.
3. Watercare has a largely temporary cash deficit resulting from on-going costs of the major weather events in January/February 2023, and the Ōrākei main sewer break which is undergoing major repair. The costs of these unforeseen events are on-going in the current year and unavoidable. Being prudent, Watercare is assuming insurance receipts will not cover these in the short-term leaving a temporary cash deficit to be funded in FY2023/2024 of \$30 million. This includes both capex and opex related costs.
4. Watercare requires additional working capital headroom to manage the increase and timing of Central Interceptor project payments (\$50 million), and to allow for timing of large creditor payments and fluctuations in working capital requirements (\$50 million). This headroom will ensure there is no inadvertent breach of debt covenants as a result of timing.
5. Auckland Council Group Treasury has confirmed the funding is available to support this request and it does not materially impact Auckland Council's overall treasury risk in the short term but will increase the Council Group's debt to revenue ratio by 2-3 percent in the current year.
6. The additional interest costs associated with this request will be factored into forecasts for the Long-term Plan 2024-2034 and funded by Watercare operational revenues.

### Ngā tūtohunga Recommendation/s

That the Governing Body:

- a) whakaae / approve Watercare's request for additional debt headroom of \$130 million.
- b) tuhi ā-taipitopito / note that this additional headroom can be accommodated through additional debt but will increase the Group's debt to revenue ratio by 2-3 per cent in the current financial year (FY2023/2024).
- c) tuhi ā-taipitopito / note that any increase in borrowing by Watercare has no impact on Auckland Council's operating budgets for 2023/2024 or beyond.
- d) tuhi ā-taipitopito / note that any additional borrowings are largely temporary and have been factored into future planning and budgeting by Watercare, reflecting alignment with Auckland Council's direction on debt as outlined in the Mayoral Proposal for the Long-term Plan 2024-2034 and the Letter of Expectations for Watercare's Statement of Intent 2024-2027.

## Horopaki Context

7. Auckland Council manages the group borrowing and interest rate exposure for the wider council group and provides the debt funding facility used by Watercare.
8. For FY2023/2024 Watercare indicated borrowings of \$485 million were required to fund the budgeted level of capital expenditure which is projected to exceed \$1 billion. The remainder of Watercare's cash funding comes from operational income, including residential and commercial tariff revenue and developer charges.
9. Cash forecasting by Watercare has indicated that additional debt headroom will be required this financial year.
10. There are a number of factors contributing to this situation, the most significant being a temporary cash deficit due to the potential timing of insurance receipts to cover costs of the significant Auckland Anniversary and Cyclone Gabrielle weather events, increased cost of the Central Interceptor project, and an allowance for working capital fluctuations.
11. The total additional debt headroom requested by Watercare is \$130 million. Watercare management and Board are conscious of the council group debt position and have carefully considered the quantum of this request. Watercare have where possible delayed commencing some projects to mitigate other project cost increases into the current year funding envelope.

## Tātaritanga me ngā tohutohu Analysis and advice

12. Watercare prepares an annual plan which outlines forecast revenue, expenditure, pricing and debt requirements. The FY2023/2024 plan included over \$1 billion in capital expenditure and new cash borrowings of \$485 million. Forecasting by Watercare confirms an actual cash requirement for FY2023/2024 of \$615 million – an increase of \$130 million. The following summarises the drivers for this additional requirement and how Watercare is managing its cash position and the impact on Auckland Council's debt position and overall risk.

### Timing of insurance receipts (\$30 million)

13. Included in the Watercare FY2023/2024 annual plan was an expectation of \$80 million in insurance receipts associated with the impact of the 2023 Anniversary Weekend flooding. Based on the rate of progress of Watercare's damage assessments, not all of the estimated \$80 million is expected to be received in the current financial year. This creates a significant timing issue in terms of covering the cost of recovery and remediation.
14. Compounding this issue, is the significant costs associated with the Ōrākei sewer main break in September 2023. This was a major incident for Watercare resulting in significant environmental impact. The remediation work and permanent fix are estimated to cost \$32 million (opex and capex) in FY2023/2024. While an insurance claim will be made in relation to this incident, no insurance receipts are expected until the FY2024-2025 financial year.
15. The total estimated cashflow impact of both the flooding and Ōrākei sewer main break for FY2023/2024 is \$60 million. Although Watercare have absorbed a portion of these costs into the existing funding envelope, \$30 million headroom is requested to allow for the timing issue associated with insurance receipts which are expected in FY2024/2025.

### Central Interceptor escalation payments (\$50 million)

16. The Central Interceptor (CI) is New Zealand's largest wastewater tunnel and will significantly reduce the incidence of overflows into Auckland's marine environment.



17. The CI contract was signed in March 2019 and the project has an approved outturn cost budget of \$1.3 billion, including additional scope agreed post-contract signing. Included in the contract were clauses that shared the risk, between Watercare and joint venture partners, of cost escalation measured by agreed indices. Although the risk was carefully allocated in the contract to protect Watercare, the extreme levels of cost increase in recent years has meant the inflation risk tolerance has been exceeded and escalation is now payable under the contract. The risk of cost escalation was signalled by Watercare in its [quarter one performance report](#) which was presented to the CCO Direction and Oversight Committee on 9 November 2023. The updated forecast to deliver the project is now \$1.5 billion, \$204 million higher than the original cost.
18. Timing of the escalation payments has put pressure on Watercare's cash position and an additional \$50 million of working capital headroom is required in FY2023/2024 to execute the terms of the escalation agreement. The remaining projected \$154 million of additional project cost will be absorbed into the existing Watercare capital budget over the remaining term of the project. This will mean the delay or deferral of other planned projects for example, flood repairs, Kāinga Ora development projects, North Harbour Duplication and the Whenuapai/Redhills development. The flow on effect of these delays include risk associated with increased reliance on temporary repairs, slowing release of new housing, continued peak season water risk and ongoing tankering of wastewater. Watercare have determined these deferrals to be the least detrimental within the overall plan.

#### Additional working capital allowance (\$50 million)

19. In recent years Watercare has managed its cash position with no headroom for cash timing differences or unforeseen events. Reflecting the large capital programme, the timing of cash payments and receipts, and challenges associated with weather and climate change related impacts, additional headroom is necessary.
20. For the FY2023/2024 year, an additional \$50 million of headroom is requested to allow for the timing differences between payment of suppliers and receipt of funds. It also provides some flexibility should there be further unforeseen events. All (if any) of this additional headroom may not be used but would allow Watercare flexibility to manage peak cash outflows without breaching debt limits.

#### Other considerations

21. Watercare's management and Board is very conscious of its responsibilities as a council controlled organisation (CCO) and is aware of the council group challenges associated with debt. Watercare closely monitors its cash position (weekly) and debt levels, and the Watercare finance team liaises regularly with the Auckland Council finance and treasury teams.
22. Watercare believes additional debt headroom is necessary. Any additional funding requirements will be absorbed within the existing debt envelope and the capital programme has been revised to ensure Watercare remains within the amended and agreed position. This has impacted the funding available for 40 infrastructure and renewal projects which will face delays and/or deferral. In Watercare's view, there is limited ability to further defer any in-progress capital projects to absorb the additional funding request.
23. The final debt position for Watercare will be reflected in the planning and budgeting process for the Long-term Plan 2024-2034 (LTP). Watercare management will align to the council direction on debt headroom for FY2024/2025 and beyond.
24. Watercare's operating costs have been closely managed in recent years and for FY2023/2024 are expected to be on budget (excluding flood and Ōrākei related costs). Watercare will continue to focus on its strategic cost reduction project which intends to remove \$100 million (adjusted for inflation and structural shifts) of operating costs over the next 10 years.

25. Auckland Council Group Treasury have reviewed the request and have confirmed that the additional headroom can be accommodated. They note that it does reduce debt headroom for the group but does not materially impact credit risk in the short term, however Watercare will need to align to the new LTP debt ratio once confirmed.

### **Tauākī whakaaweawe āhuarangi** **Climate impact statement**

26. Given the nature of the request, this does not have any direct impact on climate change. A number of Watercare projects included in the wider asset management plan directly or indirectly address the challenge of climate change. The request does help confirm the progression of the CI project which will have meaningful positive impact on the natural environment. Climate-related activities and issues are reported by Watercare to council's Council Controlled Organisation Direction and Oversight Committee each quarter.

### **Ngā whakaaweawe me ngā tirohanga a te rōpū Kaunihera** **Council group impacts and views**

27. From a group perspective, the additional borrowing of \$130 million will increase the debt to revenue ratio by 2-3 per cent.
28. As a portion of the additional borrowing relates to timing difference the longer-term impact on debt to revenue will be smaller than this.
29. The groups debt to revenue ratio will remain well within the council's financial strategy policy limits.

### **Ngā whakaaweawe ā-rohe me ngā tirohanga a te poari ā-rohe** **Local impacts and local board views**

30. Local board and community views and input are sought during consultation, consenting and project initiation. There is also regular communication and engagement with the community and customers associated with progress of key projects and in the management of significant events (e.g. the Ōrākei sewer main break). This request helps ensure we can complete the remediation works required as a result of the sewer main issue and flood impacts, while maintaining continuity of key projects.

### **Tauākī whakaaweawe Māori** **Māori impact statement**

31. This request does not have a direct impact on Māori. Many of the projects currently underway will result in improved environmental outcomes by reducing overflows therefore reducing the harm to te taiao, and therefore improving the wellbeing of people. This is a culturally very significant outcome for Māori and well-being.
32. Watercare engages with mana whenua throughout the course of a project life cycle. This is particularly the case with large projects (e.g. Central Interceptor, Huia Water Treatment Plant, Waikato 50). This request does not impact the processes associated with mana whenua engagement or the priorities of Watercare's Māori Outcomes Plan which is aligned to Auckland Council's Kia Ora Tāmaki Makaurau – Māori outcomes framework.

### **Ngā ritenga ā-pūtea** **Financial implications**

33. The financial implications of this request are outlined in this document.
34. Auckland Council Group Treasury has confirmed that the additional funding can be met. If approved, the additional \$130 million of debt would add 2-3 per cent to the Group debt to revenue.

35. The debt to revenue forecast for year-end including the additional \$130 million requested is expected to be around 240 per cent, well within the target of 270 per cent.
36. Any consequential opex or interest costs associated with the increased borrowings will be factored in to Watercare's LTP projections. These additional operating costs do not create an additional operating gap for the Group as Watercare will cover these costs with the operating revenues they collect.

## Ngā raru tūpono me ngā whakamaurutanga Risks and mitigations

37. There is sufficient group borrowing capacity to grant Watercare the additional headroom. However, Watercare is cognisant that the use of headroom reduces the flexibility the group has to respond to further unforeseen events and will take all necessary precautions to ensure project costs are tightly managed and to ensure Watercare can manage within the increased debt forecast.
38. Not confirming the request would put at risk the financial performance of the CI project and would mean abrupt deferral of in-flight infrastructure projects. This would result in greater long-term costs for Watercare as projects are pushed into the future.

## Ngā koringa ā-muri Next steps

39. Auckland Council Group Treasury to work with Watercare to put in place the additional headroom and action accordingly.

## Ngā tāpirihanga Attachments

There are no attachments for this report.

## Ngā kaihaina Signatories

Authors	Pramod Nair - Manager Group Financial Planning & Analysis Jamie Sinclair - Chief Corporate Services Officer, Watercare Services Limited
Authorisers	Dave Chambers – Chief Executive - Watercare Services Limited Peter Gudsell - Group Chief Financial Officer Phil Wilson - Chief Executive