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CASE STUDY

Capacity Wellington Water Management Ltd



Presenter

David Hill
Chief Executive
Capacity

Presented By



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Capacity

Wellington Water Management Ltd

Executive Summary

Wellington Water Management Limited, trading under the name of Capacity is a Council Controlled Trading Organisation registered under the Companies Act. Capacity is a joint venture between Wellington City Council and Hutt City Council to manage, water, stormwater and wastewater services on behalf of the parent councils.

Capacity commenced operations in early April 2004 with the transfer of 51 staff from the water services units of the parent councils. From that date Capacity continued the activities such as operations, maintenance, capital works and asset plan preparation previously undertaken by the councils' water services units.

Board of director's approval to the proposed company structure was received in October 2004 and staff were appointed to the new management and team positions. Capacity has a clear operational cost savings objective and to date the company is meeting savings expectations.

Capacity's medium term objective is to be acknowledged as a provider of excellent asset management services. Development in this area is a principal focus of the company, both to meet and exceed existing customer expectations and as the basis of future Capacity growth. An internal development programme is underway to ensure optimized asset policy and planning to meet best practice standards is achieved.

Capacity is also required under its Statement of Intent to assist in the establishment of integrated regional water services through out the Wellington region. The company is also empowered to grow its activities outside of the Wellington region and outside of the water services industry provided there are benefits accruing to the shareholders without the assumption of commercially unacceptable risks.

Initial Environment

Over a considerable period consideration was given to merging the water activities throughout the Wellington region. Within the Wellington region there are 5 council entities involved in water services. These include Greater Wellington, providing bulk water delivery, and Wellington City, Hutt City, Upper Hutt City and Porirua City providing water, stormwater and waste water reticulation.

While the various proposals to merge water services never reached a final consensus, on several occasions management working groups had arrived at near final outcomes that were discontinued prior to formal political discussions.

During 2002 and 2003 the 5 council entities discussed the possibilities of placing all their water services into one entity. Initial discussions included executives from all five council entities. For the first time consideration was given to merging water services together with storm water and wastewater. During the working group activities Upper Hutt, Porirua and the Regional Council withdrew prior to elected councilors consideration. The outcome was Wellington City and Hutt City placing their water services into a joint venture and establishing a company constitution enabling Greater Wellington, Upper Hutt City and Porirua City to join in the future at their discretion.

The focus of Capacity's establishment was to consolidate regional infrastructure services to derive "cost to serve" benefits while ensuring the assets remained with the councils. Likewise the infrastructure consolidation enabled region wide standardisation of asset practices and specifications without the need for political amalgamation. The merge concept was provided with impetus from the increasing requirement for asset management requirements such as asset planning and asset policy requirements flowing from the Local Government Act 2002. The potential increase in consultant or expert staff expenditure was seen as likely to impact negatively on councils with relatively smaller asset bases and would increase council costs.

The amalgamation of asset management on a regional basis was considered to provide potential for increasing service delivery while maintaining cost escalation. Consolidation of the technical expertise required for optimized asset management planning would provide a more economical spread of costs over a broader asset base. At the same time an environment more conducive to attraction and retention of high level expertise would be created over time.

Description of the Project

The business model for Capacity as agreed between the shareholding councils is for the assets together with all decisions relating to policy settings, rating and user charges to remain with the councils. Accordingly the councils remained as asset owners with Capacity becoming the asset manager using the "asset owner-asset manager" business model.

Capacity was empowered through its establishment documents to grow the business without geographic restriction or limitation on the types of future business operation. For example Capacity is not required to remain within the water services industry. Decisions on future growth are primarily for the board of directors although consultation with the shareholders is required.

Public consultation on the proposed water services joint venture highlighted concerns with any perceived transfer of water assets from public ownership. In response the establishment board of directors included two councillor directors from each shareholding council with two independent directors. Board meetings require a representative from each of the shareholders and an independent director to be present. Company registration was achieved in July 2003 with a Chief Executive appointed in November 2003.

Capacity was established with a clear aim for operational cost savings. From establishment Capacity was targeted with achieving savings of \$4.17 million over the first five years and thereafter at \$1.6 million annually.

Staff transferred from the water services departments of both councils and Capacity commenced operations from premises separated from both parent councils in April 2004. A total staff complement of 61 was involved at both councils at the time of concept origination. At Capacity's establishment a total staff of 51 staff transferred as a result of attrition during the 18 month formation period. Staff were formally advised no redundancies would result from the merging of the two council's activities into one entity.

Staff from Wellington City and Hutt City were advised of the concept plan from outset and had been kept aware of the public consultation process and formal council deliberations. Timing of staff updates was coordinated between the councils, although the content was less tightly structured. Wellington staff were all on individual employment agreements while Hutt staff were under the council collective agreement. Terms and conditions of employment were different but not so out of line as to make merging the staff an unmanageable issue. While operating in quite different ways the activities undertaken by Wellington and Hutt staff were essentially similar.

Capacity was required to utilise council services for the provision of services such as accounting. Information technology (IT), human resources (HR) unless external service provision provided a lower cost or specific shareholder approval was obtained. External service provision was arranged for IT delivery from the outset.

During the initial six months of operation Capacity used internal project teams with external support to undertake process mapping, establishment of HR and remuneration policy development. At the same time the identification of the process to be used to merge and tender the operation and maintenance contracts was undertaken. Board and shareholder reporting arrangements were also established.

A Service Level Agreement was entered into between Capacity and Wellington City and Hutt City setting out the products and services to be delivered including operational expenditure, capital expenditure, asset management plan delivery, asset policy development and the Key Performance Indicators (KPI's) and service levels together with the reporting procedures required.

Capacity staff were by late 2004 appointed into teams within the new company structure. Board and customer reporting on a monthly basis were established together with quarterly shareholder reporting. Work also commenced on the establishment of a model to measure the actual savings achieved in operational costs arising over time through reduction in council infrastructure spend. While Capacity had inherited staff from different remuneration structures, the remuneration policy adopted by the board of directors ensured that staff remuneration was consistent within a thirty month timeframe.

Issues Arising Since Commencement.

- Internal Corporate Processes. The establishment of HR systems, risk identification and management processes, Health & Safety systems, compliance reporting, board reporting, customer reporting, shareholder reporting, external communications required the development of skills not transferred from parent councils.
- Customer Delivery Focus. The transferred staff were experienced infrastructure managers, engineers and project managers used to working within a council structure. The delivery of services back to councils from an external entity required a readjustment of focus and the development of relationships on a differing basis from prior arrangements.
- Differing Shareholder Business Models. Capacity's shareholder/customers are at different positions on the business model continuum. For example Wellington City has in-house capability to undertake the majority of its functions from in-house resources with external support for specialist requirements or work flow management. Hutt City is primarily a manager of out sourced resource provision across all areas of its business. The differing levels of outsource provision has required different levels of customer interface and reporting.
- The Capacity Business Model. The Capacity financial structure has a low level of shareholder funds with all gains being returned to the owners in the year they arise. Hence the company has little ability to grow its retained earnings. The corollary is the annual operating costs are passed to the shareholder/customers on the basis of the work undertaken. Council's Long Term Council Community Plans (LTCCP's) and annual plan budgets become the principal determinant of the level of Capacity costs willing and able to be borne by customers.
- Differing Business Processes. Each customer has different internal business processes. In effect Capacity operates three systems, its own internal company processes and a different process for each customer

- aligned to the customer's internal system. Merging customer processes for simplicity while possible is often difficult as infrastructure services are themselves imbedded within overarching council systems.
- Development of Internal Culture. The development of a positive internal culture with staff identifying with the new entity was slower than generally experienced in start up entities. During the second year staff resignations reached 16% with a resultant loss of institutional knowledge. Accessing suitable engineering skills in a difficult employment market incurred delays. With the introduction of new staff the building of an appropriate internal culture quickly progressed such that staff surveys during the start of year three showed much improved results.
 - Development of a Savings Model. The establishment of a model to adequately compare actual costs incurred compared with the costs prior to Capacity establishment proved to be difficult. With the changes over time in LTCCP outcomes and annual budgets so the comparison of previous expenditure levels with current expectations includes a number of items outside of Capacity's control. The model absorbed considerable development resource to reach a level where shareholders and Capacity's directors are comfortable to rely on it as a fair representation of Capacity's contribution.

Results

Capacity is a fully established and audited entity with appropriate board governance procedures. The company has fully implemented risk identification and risk management procedures. Capacity has merged, tendered and managed for over 18 months a new contractor undertaking operation and maintenance activities on behalf of its joint owners. Since establishment and through the transition to a new contractor Capacity has consistently recorded service delivery at or above target KPIs.

The company has instituted staff policies to be able to attract and retain high performing staff to meet the ongoing requirement for optimizing infrastructure service delivery at sustainable costs. The company has successfully developed its external communication ability to present itself as a professional organisation.

Capacity has Health & Safety and incident investigation procedures operating at a high level. Capacity has appropriate emergency preparedness plans for all foreseeable events likely to impact its customers. The company has business continuity plans including procedures to cover such events as pandemics.

Capacity has put in place operational cost reductions projected to meet in full Wellington City's share of the savings target for the initial five year period ending on 30 June 2009. Projected savings for Hutt City at this time only meet around 50% of the savings target for the period ended 30 June 2009. Current projections

for meeting the ongoing combined savings target of \$1.6 million per annum, after the completion of the initial five year period, show a shortfall of approximately \$450,000 per annum or 30%. It is likely these projections will fluctuate over the next two years dependent primarily on Capacity's ability to ensure the identified savings are realised.

To achieve the savings targets in full, Capacity is committed to business growth. Capacity's strategic/business plan for the financial year ended 30 June 2008 has identified customer service delivery and growth in its revenue stream as its principal focus. Asset policy development together with best practice asset management planning are held to be the products driving growth opportunities.

In consultation with its customers, Capacity has repositioned the asset management plans for water, stormwater and waste water in 2005 for Hutt City and in 2006 for Wellington City. A programme to institute best practice asset management plans for both councils has commenced with the intention of releasing the new high level plans within 24 months.

Capacity has struggled to date to meet the level of strategic planning and asset optimization requested by Wellington City. Recruitment and internal structural changes have been implemented to refocus the company's performance in this area. As noted above a high level of performance is required not only to meet customer expectations but also to strengthen the company's ability to meet growth aspirations.

A number of internal projects are currently underway to provide the building blocks throughout the next 12 months to meet and where possible exceed customer expectations in the area of asset management.

The Future

The company's future prospects are firmly connected to its success in developing the ability and developing the reputation as a cost effective provider of excellence in asset management. Both the development of a regional water services entity and a sustainable business based upon revenue growth will require market acknowledgement of this improvement.

The cost benefits provided through the merging of the two shareholders operation and maintenance activities are likely to be sustained through the four year contract period. The contract outlines future mutual advantages to be obtained and in all likelihood future gains will arise. The savings reflect a unique opportunity that existed upon Capacity's establishment and the ability to repeat this for other entities is regarded as limited.

Discussions with potential future customers have generally focused on the provision of contracted asset management services. Capacity has been able to attract a number of excellent staff who are positive about the potential of working for an asset management specialist. Capacity is committed to being a training organisation and will ensure that the entity develops a reputation for having well trained and skilful people.

Discussions have been held with Greater Wellington Regional Council, Porirua City Council and Upper Hutt City Council at different times since early 2004 in respect to their individual involvement with Capacity. In one instance a formal proposal has been presented. To date, either the council executives or the elected representatives have decided not to utilize Capacity services. Options provided for consideration have included contracted service provision or partial ownership with services provided at cost. Discussions with the local councils will continue to seek a mutually agreeable basis for future cooperation.

Capacity and its existing customers are scheduled to review the Service Level Agreement within 18 months. While updated performance requirements can be anticipated perhaps the most important feature will be the ability to use the four year establishment period to redefine and accurately record the service delivery content required.

Transferability

The joint venture approach represented by Capacity is eminently transferable to other council entities. This transferability is not limited to the provision of water services, but would be equally applicable to a broad range of local authority functions. There is nothing in the Capacity experience to date that argues against the benefits in terms of cost or long term gains arising from infrastructure management integration.

Also transferable, as well as the joint venture approach, is the “asset owner-asset manager” model. Clearly Capacity did not invent this business model but for many this was the first time they have seen the model in practice. It has relevance for councils wishing to retain strategic asset bases while benefiting from enhanced integration. Capacity’s experience is that its customers have differing approaches to managing the interface with the asset manager. Both approaches are workable and do not in either instance detract from the overall benefits.

Conclusions

There are difficulties in taking two general purpose infrastructure teams and merging them into one entity with the aim of achieving asset management excellence.

In summary the key ones are the development of a customer delivery focus, the differing shareholder business models, the difficulties in merging processes and the slow development of a positive internal culture. None of the difficulties experienced were insurmountable.

The potential benefit to local communities, of high performing infrastructure operated and maintained at lowest cost, justify the Capacity experiment.

From outset, Capacity has received positive support from the parent council elected representatives. Capacity reports formally to the owners quarterly and the Chair and chief executive meet quarterly with the Mayor and chief executive of each shareholder. Through both the formal and informal communication channels shareholder support for Capacity has been strongly stated.

The delivery of asset management focused on optimized performance at least cost from a consolidated entity will be of particular relevance to smaller councils. Currently the smaller asset bases struggle to justify the compliance costs associated with advanced asset management practice. Consolidated entities such as Capacity provide a potential resource where specialised asset management could be acquired at costs applicable to the size of the assets.

Within New Zealand, legislative compliance has required local government entities to become leaders in asset management planning and execution. The growth in expertise has received international attention with the potential for significant draw off of specialist skills overseas. Capacity provides an example where professional skills can be concentrated in an environment conducive to long term retention.

Contact for Further Information

Name:	David Hill
Title:	Chief Executive
Company:	Capacity
Street Address:	75 The Esplanade, Petone.
Mail Address:	Private Bag 39804, Wellington Mail Centre, Petone
Telephone:	04 910 3800
Fax:	04 910 3801
Email:	david.hill@capacity.net.nz