

3Waters Reform

Meeting: Council Briefing

Date of meeting: 4 August 2021

Reporting officer: Sue Davidson, GM Sustainable Growth & Investment

Purpose | Ngā whāinga

To review the various correspondence from Central Government on 3Waters, consider the impact on Council and its ratepayers and seek direction.

Executive Summary

The Government is progressing the 3Waters reform with information released in June/July 2021 setting out the case for change and the expected impacts on communities.

The decision for Council to make is whether to transfer (or not) all water, wastewater, and stormwater assets from Council to a new entity providing the relevant services to 'Entity A' - Auckland City Council, Whangarei, Northland and Kaipara District Councils

Analysis of the RFI information has been undertaken and officers are satisfied that it is generally correct however there are some heroic assumptions. Notwithstanding that, the information received includes the following key factors which may influence the Council Decision

- Kaipara District Council has the lowest proportion of connected properties (25% compared to 94% in Auckland and 64% in Whangarei)
- Kaipara has the highest cost per connected household however the actual cost is lower due to charges on unconnected properties. Kaipara is circa \$2.5k compared to an average of \$1k across the entity
- 3Waters debt varies significantly across Councils, with Whangarei having very little 3Waters debt and Kaipara having significant 3Waters debt, relative to overall Council debt

There are risks to opting in or out of the of the proposal. There are a number of aspects which affect Council which are unknown at this stage and clarity of these aspects may assist Council decision making:

- Land drainage and flood protection.
- People and locations – Extract from LGNZ – 'We've heard at Conference that staff working primarily on water will be guaranteed a role in the new entities, with the same salary, conditions and – critically – location'.
- Asset valuation.
- Transfer of debt.

If the decision is made to opt in, then further work will be undertaken to clarify what is transferred to the new entity including reserves, revenue and debt

- Reserves - **\$1,631k**. Potentially these reserves would be an asset transferred to Central Government. For the 2022 annual plan we will ensure we try and use these funds.
- Revenue – \$11,895
- Debt – \$52.3m

The Government's has developed a 3Waters Reform support package and comprises two broad elements to support transition:

- A 'better off' element: an investment of \$2b into the future for local government and community wellbeing, consistent with the priorities of both central and local government; and
- A 'no Council worse off' element: an allocation of up to around \$500m to ensure that no local authority is in a materially worse position financially to continue to provide services to its community as a direct result of the reform.

There are no decisions to be made at this stage as the implementation of this package will be aligned with the new entity.

Context | Horopaki

Havelock North Inquiry- Trigger

The current reform has been triggered by the Havelock North Water Incident in 2016 where contaminated groundwater entered the water network and led to 5,000 people falling ill, and consequentially four deaths. The subsequent Government inquiry in 2017 observed that New Zealand had fallen well behind international best practice in the delivery of drinking water and made wide ranging reform recommendations.

The Government is acting on these in the current reform programme.

In January this year the Department of Internal Affairs asked for information on Councils 3Waters - Water, wastewater, and stormwater assets. The request covered both financial, performance and asset management information of these assets that are being discussed are the water, wastewater and stormwater treatment facilities, lagoons, pipes (reticulation network), pumps and all associated infrastructure.

The Havelock North inquiry outlined six principles of drinking water safety

- A high standard of care must be embraced.
- Protection of source water is of paramount importance.
- Maintain multiple barriers against contamination.
- Change precedes contamination.
- Suppliers must own the safety of drinking water.
- Apply a preventative risk management approach.

Recent Proposed Water Reforms

More recently Central Government has provided Councils with key reports of the Water Industry Commission of Scotland and various correspondence from the Department of Internal Affairs (DIA) that build a case for change in ownership and management of 3Waters. The Government is promoting the case for change through newspapers, TV and other media directly to the public. The process to go through will involve consultation with the public prior to any decision having to be made by the Council as to the transfer of these assets.

The decision is to be made is to transfer (or not) of all water, wastewater, and stormwater assets from Council to a new entity providing the relevant services to Auckland City Council, Whangarei, Northland, and Kaipara District Councils. There will be four crown water entities created to cover all of NZ and the new entities are to be providing services at the latest by 1 July 2024. The Government is planning for the control and ownership of all Council's 3Waters assets to be transferred to the new Northern crown entity. The Government will ensure the newly formed water services entities will remain in public ownership.

Whangarei District Council met on the 29 June and voted against the Governments plans to amalgamate its 3Waters infrastructure into a single entity for Northland and Auckland. Their justification is based on low debt and in a strong position to continue to look after their systems.

The status quo for drinking water standards and services was not an option and formed a new and dedicated regulator 'Tuamata Arowai'.

More recently the Government provided KDC with \$4,691,048 as part for funding renewals relating to the 3Waters investment stimulus package. These funds are currently being used to renew a backlog of water and wastewater projects in various communities in our district. This was in exchange for our Council considering the Governments deal for the rest of the water, wastewater and stormwater assets.

An overview of the 3Waters reforms is included as *Attachment A*.

Other Relevant Reforms

Water is one piece of the puzzle as Government has also started to progress change in other areas.

Other reforms which also have the potential to impact on this Council and are moving at pace are the reform of the Resource Management Act which is looking to more regionalisation of these functions and all Local Government Reform. See *Attachment B*.

Local Government Act

The Local Govt Act provides under Section 130 the obligation to maintain water services and not to divest ownership except to another local government organisation. In terms of our significance policy the transfer of all water assets would require using the special consultative process, so the final decision cannot be made by Council alone under the current legislation.

Governments objectives for the three water reform programme

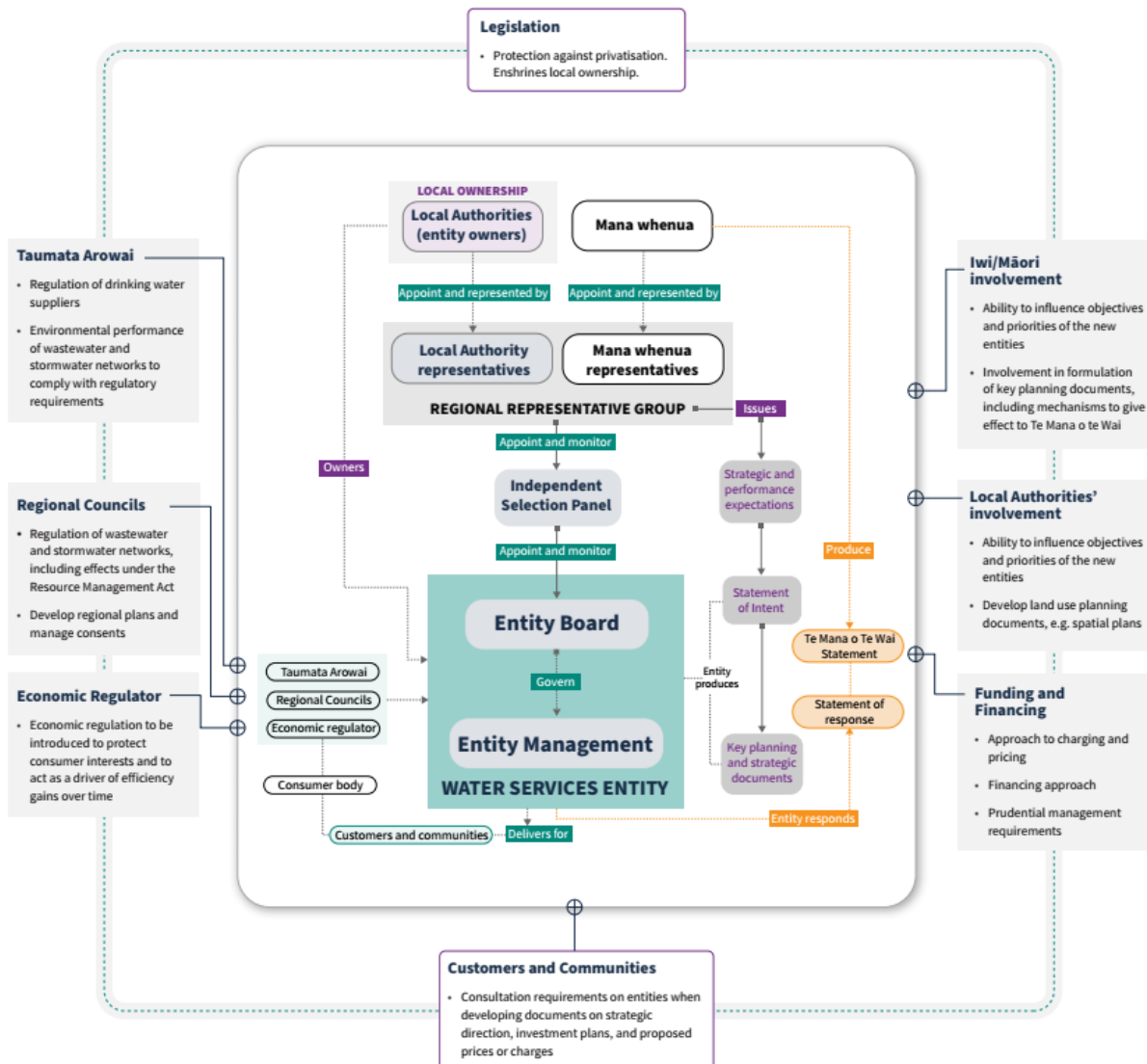
- That there are safeguards against privatisation and mechanisms that provide for continued private ownership.
- Significantly improve the quality and safety of drinking water services.
- Ensuring all New Zealanders have equitable access to affordable 3Water services, and that the water entities will listen to their local communities.
- Improving the coordination of water services and planning.
- Ensuring the overall integration and coherence of the wider regulatory and institutional settings.
- Increasing the resilience of the 3Waters service provision to both short and long term risks, particularly climate change and natural hazards.
- Moving the supply of 3Waters to a more financially sustainable footing and addressing the affordability and capability challenges.
- Improving transparency and accountability for the planning and delivery and costs of 3Water services.
- Undertaking the reform in a form that enables local government to continue delivering on its placemaking role and broader wellbeing mandates.

Discussion | Ngā kōrerorero

This section discusses

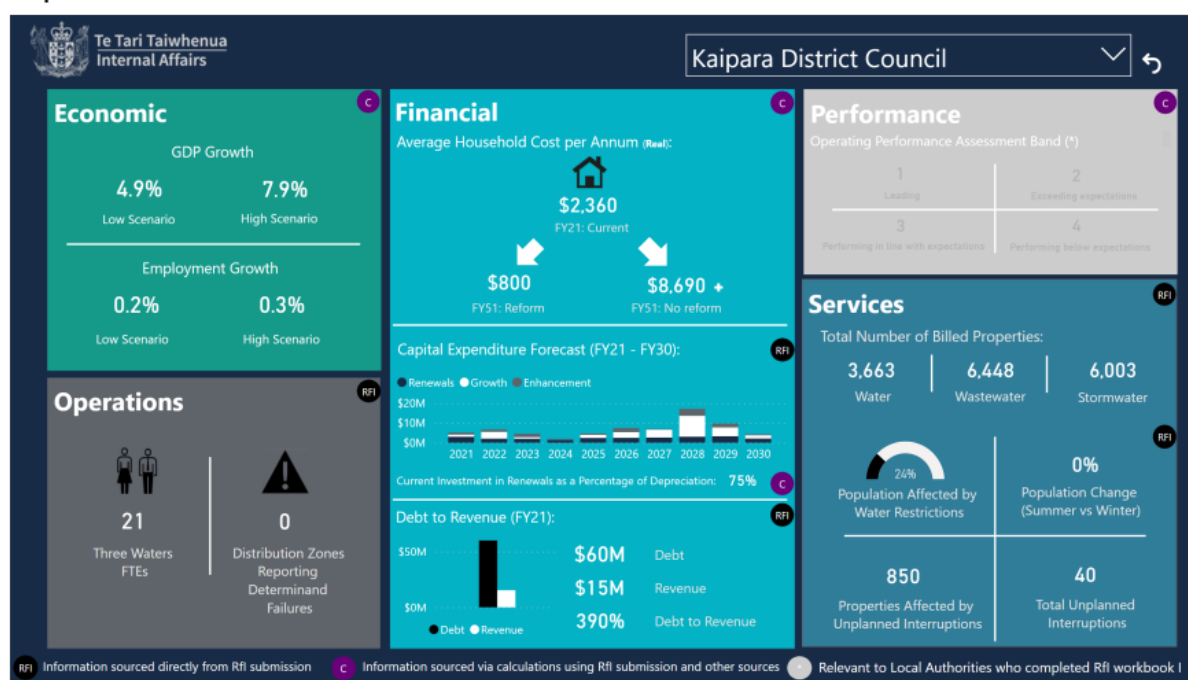
- Analysis of RFI information / DIA model
- Financial impacts
- Risks of opting in / out
- 3Waters support package

Governance of the proposed 3Water entities



Analysis of RFI information / DIA model

Kaipara District Council Dashboard



What is the information telling us?

Analysis of the information received includes the following key factors which may influence the Council Decision

- Due to the availability of 3Waters services across the entity, there is variability in the number of connected properties between services. Kaipara District Council has the lowest proportion of connected properties (25% compared to 94% in Auckland and 64% in Whangarei)
- Within the study area Kaipara has the highest cost per connected household, however the actual cost is lower due to charges on unconnected properties. Kaipara is circa \$2.5k compared to an average of \$1k across the entity
- 3Waters debt varies significantly across Councils, with Whangarei having very little 3Waters debt and Kaipara having significant 3Waters debt, relative to overall Council debt

Is the information correct?

- Looking at the model the assumptions as to the current cost of water, wastewater and stormwater are about right.
- The model is based on assumptions used in the Scottish model as the populations are similar although NZ has 3.44 times the land area and populations are sparser.
- The model assumes that water and wastewater consumers will be around the same number. Connections of 4,159 are the models Councils actual figures are Water 3,446 Wastewater 5,334 and Stormwater 6,321.
- The revenue is then divided by the estimate of households to get the cost to ratepayers.
- The KDC LTP has the following revenue details for waters:

Activity	Source	2020-2021 Actuals \$'000	2030-2031 LTP projection \$'000
Stormwater	Rates	\$1,688	\$3,820
Wastewater	Rates	\$6,573	\$9,171
Water supply	Water by meter	\$3,147	\$5,518
	Other revenue	\$487	\$537
		\$11,895	\$19,046

- The dashboard presented to Council as to assumptions as to cost that will be charged by this Council in 2031 seem too high.
- General assumptions are that large multiregional entities will achieve 30% - 40% operating efficiency over the next 30 years as has been shown in the Scottish example and wider international studies.
- Despite the many assumptions in the model can be agreed that a smaller number of entities will mean water will cost less to the consumer – our ratepayers.
- DIA have stated the assets and their operations will be transferred to a separate entity and that all water related staff (engineers) will be protected and transferred to the new entity.
- For our ratepayers to make savings though, Council will need to consider what it does with the overheads that were previously charged to the 3Waters and what efficiencies they must make, as the overheads will remain in Council and not be transferred. Economies of scale will only be achieved if the Council looks to reduce corporate overheads, and staff rationalisation. Many staff in our Council have multidisciplinary responsibilities and this would need to be considered.

Financial impact of opting in

History of Funding Renewals

Kaipara District Council which is a small Council which has not fully funded critical infrastructure replacement costs. From 2010 the priority for ratepayer funds collected was to reduce debt because of the investment in the Mangawhai Wastewater solution.

Renewals are normally funded from rated depreciation funds. Minimal renewals and maintenance was carried out on all Council assets over this subsequent decade and depreciation was only starting to be rate funded on water, wastewater and stormwater assets from July 2016 at 16.67%. 2021/22 is the first year that depreciation has been fully funded and this means the Council can provide for an improved asset management system renewing its infrastructure in a timely manner. The one exception is the Mangawhai Wastewater System which is funded 66% in 2021/22 and rising to 100% by the end of 2024/25 when all assets apart from roading are fully funded.

Depreciation reserves (000s) which have built up as at the June 2020 are:

Water	\$ 870
Wastewater	\$ 181
Stormwater	\$ 580
Total	\$1,631

Potentially these reserves would be an asset transferred to central government. For the 2022 annual plan we will ensure we try and use these funds (renewals and new projects).

Financial Overview

Assets

	Depreciated value \$000 2020	% Assets	Replacement Costs (latest estimate 2020)	Revenue (rates - water by meter) \$000 pa 2021	%
Water	\$36,074	4%	\$77,532	\$3,634	9%
Wastewater	\$62,613	8%	\$87,589	\$6,573	15%
Stormwater	\$34,230	4%	Not recorded	\$1,688	4%
Other (primarily roading)	\$670,970	84%		\$30,047	72%
Total	\$803,887	100%		\$41,942	100%

Total Revenue has normally been around \$60m but has been exaggerated lately because of the subsidies we have been able to get. 3Waters are about 28% of our business which is significant. The revenue would be collected by the new entity in the future.

The costs of the 3Waters would also be transferred apart from the corporate overheads allocated to water. The overheads would need to be reviewed and reduced as the remaining Council business could no longer sustain this. This totals approximately \$2m which is significant.

Debt

A summary of outstanding debt (000s) is as follows:

\$000	Water	Wastewater	Stormwater
Dargaville	\$1,714	\$1,466	\$1,332
Maungaturoto	\$1,422	\$1,232	
Maungaturoto (Fonterra)	\$1,424		
Mangawhai	\$11	\$41,645	\$1,228
Ruawai	\$213		
Glinks Gully	\$97	\$73	
Te Koporu		\$46	\$34
Kaiwaka		\$191	\$22
Baylys			\$244
Total	\$52,394	\$44,653	\$2,860

Rateable properties are approximately 15,000 and there are about 8,100 households in the District.

Debt ceilings are not a problem now for KDC nor will it be in future if 3Waters is divested.

Remaining Council debt would be approximately \$4m outstanding (likely all internal) on other assets or on the District Plan. Councils' debt position is currently not considered to be high and there is ample flexibility to borrow more with or without the 3Waters.

Based on the possible rates revenue only being \$30m and other revenue being \$20m external debt could be raised to a maximum of \$85m. This is the maximum per our treasury ratios (net debt as a percentage of total revenue < 170%)

Council also has millions of dollars of swap obligations and we will need to confirm that we can assign these with the debt otherwise we will pay the difference in interest costs.

Information on assets from the Infrastructure Strategy

Meeting required standards

Council meets all drinking water standards on its treated water systems as at 2021.

Condition of Assets

Much of the original infrastructure has been built with the help of Government subsidies and some communities struggle to budget for and pay for the renewal of this infrastructure, and this is driving some of the 3Waters dynamic.

The affordability of infrastructure investment, renewal, operations, and maintenance is one of the major drivers of the governments three water reform programme. Many previous government reports ie Shand Report, Productivity report have shown that local government is underfunded.

Generally, growth and future demand is not well resourced and falls on local Councils who have to be careful in committing to the infrastructure they put in as it will be paid for over future years (say the next 30 years)

If levels of service are to increase, then more resource will be needed in local Councils. It is anticipated more compliance analysis, reporting, and management with water quality, regulatory and economic regulator expected. This will push up our cost structure in the LTP as much more data will be needed for reporting and decision making.

Climate change adaption, sea level rise drought, larger and more frequent storms are all issues that will increase in effect on KDC

Water Supply

Kaipara's water supply infrastructure is aged and in largely poor condition. The overall poor condition results in an increased risk of failure and significant repair costs. Over the next 10 years the depreciation funded is totally funding renewals because of the backlog.

Water supply is becoming more critical with climate change and increased risk of more frequent droughts.

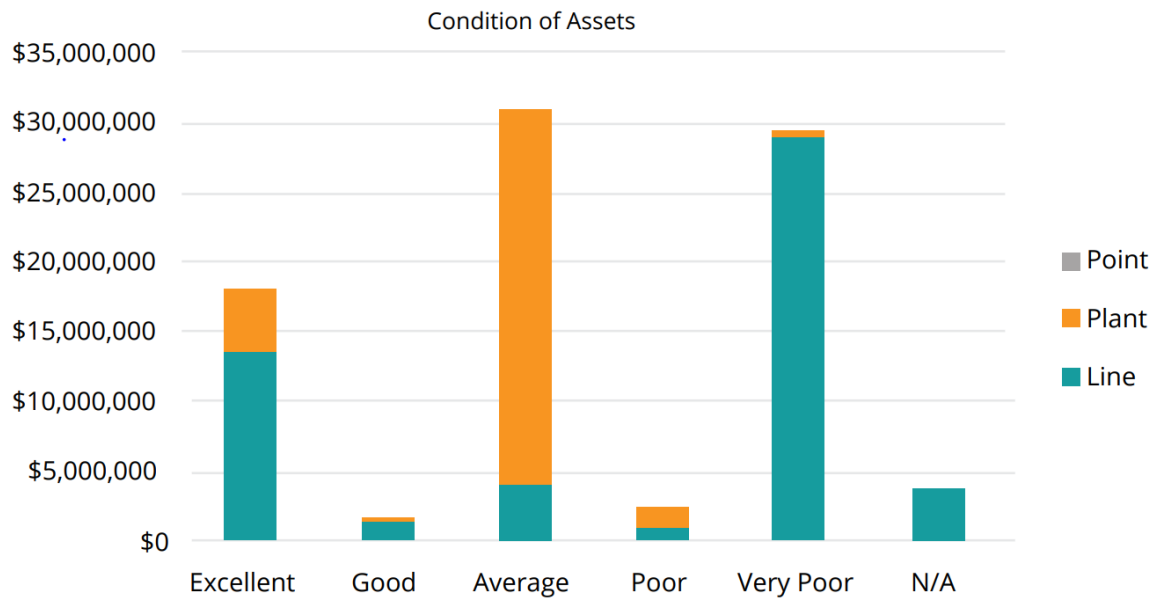


Figure 14. Condition of Water Supply Assets

Prospective Infrastructure Strategy Costs

For the year ended: 30 June	Total Water Supply Budget (\$'000)						
	2021-26	2026-2031	2031-2036	2036-2041	2041-2046	2046-2051	2021-2051
Total operating expenditure	16,694	17,692	20,510	23,775	27,004	30,629	136,304
Capital Expenditure - Growth	206	984	13,286	1,852	0	0	16,327
Capital Expenditure - LoS	579	0	0	0	0	0	579
Capital Expenditure - Renewal	7,227	9,201	11,149	12,186	8,568	9,741	58,072
Total capital expenditure	8,011	10,185	24,435	14,038	8,568	9,741	74,978
Total expenditure	24,705	27,877	44,945	37,813	35,572	40,370	211,282

Wastewater

Most of Kaipara's wastewater network is 11-20 years old. The wastewater network is in average condition/above average condition. Over the next 10 years the reserves for funded depreciation will accumulate for future capital expenditure.

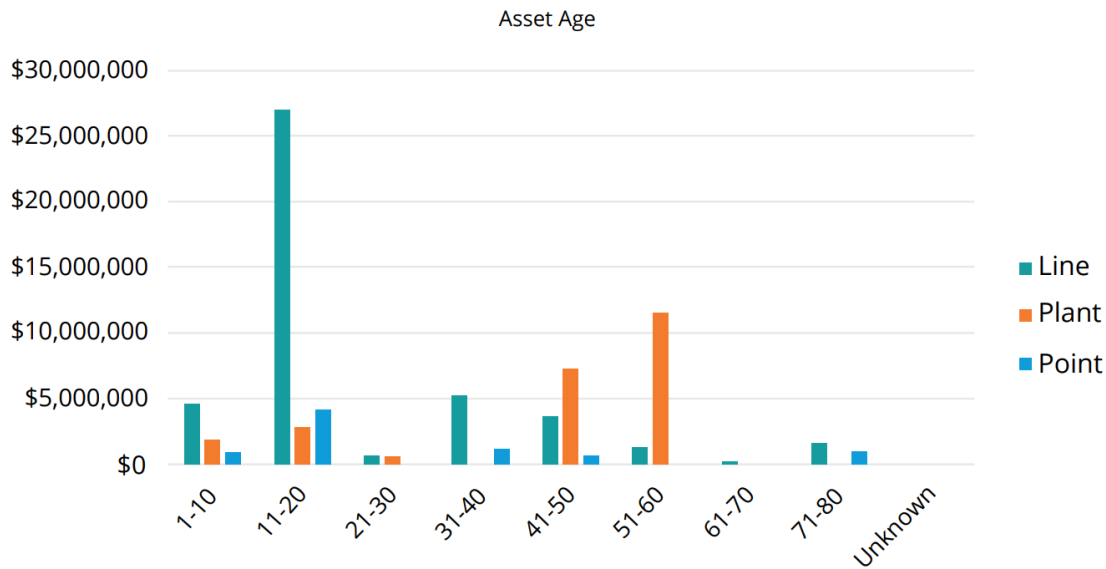


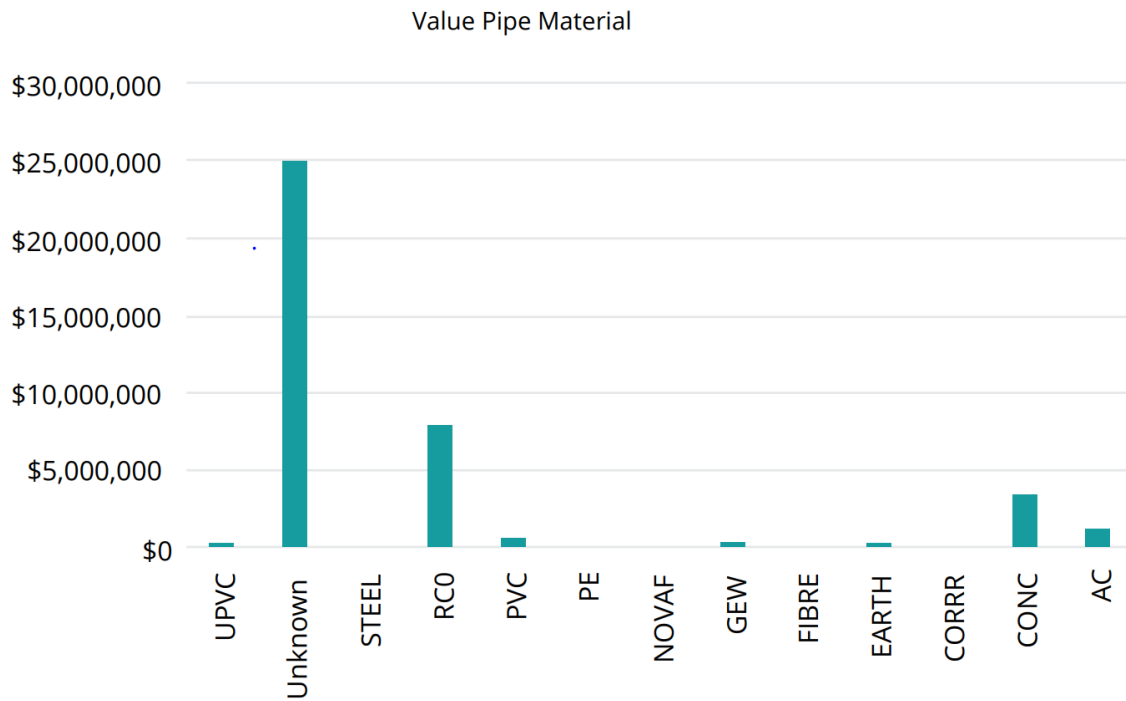
Figure 16. Wastewater Asset Age

Prospective Infrastructure Strategy Costs

For the year ended: 30 June	Total Wastewater Budget (\$'000)						
	2021-26	2026-2031	2031-2036	2036-2041	2041-2046	2046-2051	2021-2051
Total operating expenditure	28,429	28,740	33,716	38,406	40,240	41,665	211,195
Capital Expenditure - Growth	9,404	19,790	23,752	7,034	1,333	1,515	62,827
Capital Expenditure - LoS	574	3,032	4,774	3,349	3,808	4,329	19,867
Capital Expenditure - Renewal	3,249	2,966	2,201	2,502	734	814	12,466
Total capital expenditure	13,227	25,788	30,727	12,885	5,875	6,659	95,161
Total expenditure	41,655	54,528	64,444	51,291	46,115	48,323	306,356

Stormwater

The District has 83km of pipes and 70km of open drains and stormwater condition is unknown. Over the next 10 years it is forecast a reserve will build up in stormwater depreciation.



Prospective Infrastructure Strategy Costs

For the year ended: 30 June	Total Stormwater Budget (\$'000)						
	2021-26	2026-2031	2031-2036	2036-2041	2041-2046	2046-2051	2021-2051
Total operating expenditure	6,421	7,479	8,388	8,879	9,289	9,880	50,336
Capital Expenditure - Growth	2,142	7,440	626	712	476	541	11,937
Capital Expenditure - LoS	4,290	5,350	44	50	190	216	10,141
Capital Expenditure - Renewal	924	3,926	2,320	2,638	1,423	1,618	12,849
Total capital expenditure	7,355	16,717	2,990	3,400	2,090	2,376	34,927
Total expenditure	13,776	24,196	11,378	12,278	11,378	12,255	85,262

Local retention of 3Waters services (risks/benefits/options)

Council risks with the 3Waters Reform

1. Council risks regarding **opting out of** the 3Waters reform are:
 - a. Ability to fund the infrastructure deficit required to be addressed to meet the new service level and Taumata Arowai regulatory requirements.
 - b. Ability to resource infrastructure service delivery requirements – staff and external support. Staff retention may prove difficult for individual Councils.
 - c. Possible National Environmental Regulator may introduce a range of higher environmental related service levels.
2. Council risks regarding **opting into** the 3Waters reform are:
 - a. There are resilience risks associated with centralised management and services delivery verses local management and services, but this should be mitigated by retaining some staff in the local areas.
 - b. The ability for Council to facilitate development in the district. Currently the Council develops the 30 Year Infrastructure Strategy which responds to desired growth. Pro-active engagement with developers is sought to enable the right outcome. The risk is that we are not able to achieve an integrated outcome to development or prioritise investment which will enable sustainable growth
 - c. There is a risk that Council does not have the capacity / capability to manage remaining infrastructure, specifically Parks & Open Spaces and Land Drainage
 - d. The loss of the 3Waters business from Council, and potentially business relating to Resource Management is will mean costs have to be trimmed to be sustainable to our ratepayers. Overheads would be stranded as there would be less services for these to be spread over.

The Offer

The Government's has developed a 3Waters reform support package and comprises two broad elements to support transition

There are two parts to the offer

The Crown is proposing that a 3Waters Reform financial support package be provided to local authorities, comprising:

(a)

a 'no worse off' package which will seek to ensure that financially, no local authority is in a materially worse off position to provide services to its community directly because of the 3Waters Reform Programme and associated transfer of responsibility for the provision of water services (including the transfer of assets and liabilities) to the Water Services Entities. This will be funded by the relevant three services entity at the time of water transfer, as this is when most of the financial impacts will crystallise.

- Need to negotiate transaction costs associated with the transfer of assets, liabilities, revenues, including staff involvement working with the establishment entities and transition unit, and legal, accounting and audit costs-This is likely to include back up for water staff
- Accumulated cash reserves earmarked for future water infrastructure. Local authorities will be encouraged to use these reserves and the government will disclose a materiality level balance that can be retained
- Payment to local authority by the relevant water services entity, being the amount of debt established through any due diligence/audit relating to 3Waters
- Stranded costs, being organisational overheads previously allocated by the local authority to 3Waters services that are not able to be transferred or avoided (potentially 2 years and it is likely to be based on a per capita rate recognising smaller Councils face disproportionate costs (\$150m in total excludes Auckland, Christchurch, and Wellington water

- Potentially more to fund stranded overheads if Government thinks we have been adversely affected by overheads(\$50m)
- Potentially a one off payment for a small number of Councils that may not be able to finance their non-water related functions-unlikely to be KDC

And (b)

a 'better off' package of \$2 billion which supports the goals of the 3Waters Reform Programme by supporting local government to invest in the wellbeing of their communities in a manner that meets the priorities of both the central and local government and is consistent with the agreed criteria for such investment.

- Demonstrates central government confidence in the future of local government, with 25% provided from 1 July 2022 to enable early investment, and 25% from 1 July 2024.
- 50% will be funded by the new water services entities from 1 July 2024.
- Funding based on population, deprivation index and land area. KDC has been allocated \$16,141,395.

Criteria

- supporting communities to transition to a sustainable and low-emissions economy, including by building resilience to climate change and natural hazards.
- delivery of infrastructure and/or services that:
 - enable housing development and growth, with a focus on brownfield and infill development opportunities where those are available.
 - support local place-making and improvements in community well-being.

Conditions

- Expected to engage with Maori in determining how this will be used.
- Expected to work collaboratively.
- Continue commitments in LTP.
- Assisting in the preparation of initial asset management plans.

Council options regarding the 3Waters Reform

1. Transfer assets and staff to the new multi-regional entity, Council no longer provides 3Waters services.
2. Opt-out of the structural reform, Council continues to provide 3Waters services within the new regulatory framework-still an option at present time.

Next steps | E whaiake nei

More information will be sought from LGNZ and central government to understand the offer and further discussion will be held Council.

Local authorities will be provided a reasonable period (about eight weeks from the LGNZ conference) to consider the impact of the reforms and financial support package on the Councils and their communities and provide feedback.

A paper will be brought to the August Council Meeting where a decision will be required on the package.

The government advises formal consultation doesn't need to occur till after 8 weeks when they decide next steps

At the end of this period the government may decide to adopt an 'all in' legislated approach to 3Waters Reform

Attachments | Ngā tapiritanga

	Title
A	Overview of the 3Waters reforms
B	All Local Government Reform