Attachment A - funding to invest in the future of local government and community wellbeing

1. On 15 July, in partnership with LGNZ under a Heads of Agreement[2], the Government announced a package of $2.5 billion to support councils to transition to the new water entities and to invest in community wellbeing.
2. The '**better off' element**: an investment of **$2 billion** into the future for local government and community wellbeing.
    - The investment is funded $1 billion from the Crown and $1 billion from the new Water Services Entities. $500 million will be available from 1 July 2022. The funding has been allocated to territorial authorities (which includes unitary authorities)[3] on the basis of a nationally formula that takes into account population, relative deprivation and land area.
    - The funding can be used to support the delivery of local wellbeing outcomes associated with climate change and resilience, housing and local placemaking, and there is an expectation that councils will engage with iwi/Māori in determining how to use their funding allocation.
3. The **'no council worse off' element**: an allocation of up to around $500 million 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.
    - This element is intended to ensure the financial sustainability of councils and address reasonable costs and financial impacts associated with the transfer of assets, liabilities and revenues to new water services entities.
    - Up to $250 million is available to meet the unavoidable costs of stranded overheads and the remainder for other adverse impacts on financial sustainability of territorial authorities (including future borrowing capacity).
    - Of this $250 up to $50 million is allocated to Auckland, Christchurch and Wellington Water councils, the remainder is available to other councils.[4] This funding is not available until July 2024 and is funded by the Water Services Entities.
4. Council's funding allocation is 16.1m.
5. The package is in addition to the $296 million announced in Budget 2021 to assist with the costs of transitioning to the new three waters arrangements. The Government will "meet the reasonable costs associated with the transfer of assets, liabilities and revenue to new water services entities, including staff involvement in working with the establishment entities and transition unit, and provision for reasonable legal, accounting and audit costs."[5]
6. The Government is also encouraging councils to use accumulated cash reserves associated with water infrastructure for this purpose. There are likely to be practical limitations on a council's ability to do this set by councils' own financial strategy and policies (including conditions on the use of the reserves ie targeted reserve funds must be used for the purpose they were collected for in the first instance e.g. if collected for capital works).
7. There are also political and / or community acceptance challenges with this approach - if the assets are transferred under a voluntary or mandatory process the reserve balances are expected to be used to invest those funds in the communities that paid for them, consistent with the conditions under which they were raised rather than pooling as a general fund. Councils and communities are unlikely to embrace using these funds instead to enable the transition.

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[2] https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/heads-of-agreement-partnering-commitment-to-support-three-waters-service-delivery-reform.pdf

[3] Please note that any allocation to Greater Wellington Regional Council (the only regional council affected by the proposed changes) is not clear at this stage.

[4] Due to their size and in the case of Wellington Water and Auckland's WaterCare having already transferred water service responsibilities (to varying degrees)

[5] 15 July 2021 FAQ https://www.dia.govt.nz/diawebsite.nsf/Files/Three-waters-reform-programme/$file/three-waters-reform-programme-support-package-information-and-frequently-asked-questions.pdf

8. The proposed national allocations are as follows:

Council	Allocation
Auckland	$ 508,567,550
Ashburton	$ 16,759,091
Buller	$ 14,009,497
Carterton	$ 6,797,415
Central Hawke's Bay	$ 11,339,488
Central Otago	$ 12,835,059
Chatham Islands	$ 8,821,612
Christchurch	$ 122,422,394
Clutha	$ 13,091,148
Dunedin	$ 46,171,585
Far North	$ 35,175,304
Gisborne	$ 28,829,538
Gore	$ 9,153,141
Grey	$ 11,939,228
Hamilton	$ 58,605,366
Hastings	$ 34,885,508
Hauraki	$ 15,124,992
Horowhenua	$ 19,945,132
Hurunui	$ 10,682,254
Invercargill	$ 23,112,322
Kaikoura	$ 6,210,668
Kaipara	$ 16,141,395
Kapiti Coast	$ 21,051,824
Kawerau	$ 17,270,505
Lower Hutt	$ 38,718,543
Mackenzie	$ 6,195,404
Manawatu	$ 15,054,610
Marlborough	$ 23,038,482
Masterton	$ 15,528,465
Matamata-Piako	$ 17,271,819
Napier	$ 25,823,785
Nelson	$ 20,715,034
New Plymouth	$ 31,586,541
Opotiki	$ 18,715,493
Otorohanga	$ 10,647,671
Palmerston North	$ 32,630,589
Porirua	$ 25,048,405
Queenstown Lakes	$ 16,125,708
Rangitikei	$ 13,317,834
Rotorua Lakes	$ 32,193,519
Ruapehu	$ 16,463,190
Selwyn	$ 22,353,728
South Taranaki	$ 18,196,605
South Waikato	$ 18,564,602
South Wairarapa	$ 7,501,228
Southland	$ 19,212,526
Stratford	$ 10,269,524
Tararua	$ 15,185,454
Tasman	$ 22,542,967
Taupo	$ 19,736,070
Tauranga	$ 48,405,014
Thames-Coromandel	$ 16,196,086
Timaru	$ 19,899,379
Upper Hutt	$ 18,054,621
Waikato	$ 31,531,126
Waimakariri	$ 22,178,799
Waimate	$ 9,680,575
Waipa	$ 20,975,278
Wairoa	$ 18,624,910
Waitaki	$ 14,837,062
Waitomo	$ 14,181,798
Wellington	$ 66,820,722
Western Bay of Plenty	$ 21,377,135
Westland	$ 11,150,183
Whakatane	$ 22,657,555
Whanganui	$ 23,921,616
Whangarei	$ 37,928,327
Total	$ 2,000,000,000

Appendix B – Response to Elected Members Questions

1. I understand the concept of an economic regulator keeping a watch over the entities. But I'm interested in who the economic regulator is accountable to? Is it Central Government or Local Government? How will local affordability issues be recognised and addressed?

A discussion paper on three waters economic regulation is due to be published later this year.

Mechanisms that we anticipate will be considered through the paper include:

- *the design of an appropriate dispute resolution process;*
- *the establishment of a consumer advocacy council (or the extension of an existing body) to provide expert advocacy on behalf of consumers;*
- *options to protect consumers who are vulnerable due to their age, health, disability, or financial position;*
- *an ability for a regulator to mandate service quality codes;*
- *the process for setting prices, including requirements for pricing transparency.*

Economic regulation falls within the portfolio of the Minister of Commerce and Consumer Affairs. Preparation of advice will be led by the Ministry of Business, Innovation and Employment, in consultation with the Department of Internal Affairs and the Treasury.

2. There is a particular concern for Entity A with regards to the ability of the Shareholder group to influence the culture of the entity. Auckland and Watercare have an existing relationship. It is likely that Watercare (perhaps in a new format) will be the service delivery entity. How will Northland Councils have influence over the relationship and gain priority for their regions?

To answer your first question on Watercare's future role in service delivery – these decisions are yet to be taken and would be worked through as part of the transition period.

Regarding community priorities, Councils would have influence through their role in the Regional Representative Group and directly through the strengthened consumer and community engagement, transparency and protection mechanisms that are proposed as part of the package of reforms. This group would be made up of mana whenua and local authority representatives and would provide a mechanism for the inclusion of more local and regionalised priorities and objectives to guide entities' behaviours and decisions.

The Representative Group would be required to consider the interests of the relevant jurisdictions within an entity area when exercising their functions and decision-making powers in setting the strategic direction and oversight of the entities. Representatives would likely vote on decisions that require a Representative Group decision and will typically have a single vote each. However, as outlined in the Cabinet paper, no single local government or mana whenua representative would have a veto right or ability to exert negative control over decisions for the Representative Group.

The water service entity would also be required to engage in a meaningful and effective manner with their consumers and communities on the preparation of the investment prioritisation methodology, the asset management plan, and the funding and pricing plan. This would provide consumers and *communities (including individual councils) with opportunities to give direct feedback to the entities before final prioritisation decisions are made.*

The entity would then be required to take the feedback into account, would be required to make public the final documents and publish a report outlining how the feedback was incorporated into their decision making. This means that communities would have the ongoing opportunity to directly input into prioritisation decisions and would provide a level of transparency for how the decisions were made by the entity.

Additionally, to strengthen the engagement and consultation of the wide range of stakeholders and communities within an entity, each water service entity would be required to establish their own consumer forum. The purpose of this forum would be to assist with the communication and engagement on the technical aspects of the key business documents, and to ensure the range of consumer interests are being considered by the entity when finalising important decisions.

3. Can Spatial Planning and Long Term Plans workplans be mandated so the Entity must give effect to them? If not, how will significantly smaller shareholders ensure their community interests are addressed?

The proposed water service entities will need to operate within wider planning, regulatory system and reporting and accountability arrangements, including the future resource management system, the water quality regulation administered by Taumata Arowai and the proposed economic regulatory environment.

It is proposed legislation is put in place to provide for statutory obligations on the water services entities to support an integrated planning approach. This is further work that will be developed over the next 12 months in parallel with the resource management reforms.

These obligations would ensure that urban planning authorities, the new water services entities, and other infrastructure providers, coordinate the planning and delivery of the right infrastructure, at the right time, in accordance with commitments in agreed urban growth strategies, and spatial and implementation plans (including those provided for under the new resource management system).

4. How will Land Drainage schemes be addresses – particularly where those have been community funded and led for many decades?

Land drainage scheme will continue to be worked through during the transition period. However, please see the below for the current positioning on drainage assets (subject to change):

- ***Existing ownership of the land and/or stormwater assets should be retained where possible**.*
- *The **transfer of stormwater assets** to the water service entities, and/or the ability of water entities **to protect stormwater functions** will be identified based on their **predominant use, and criticality** for the operation of stormwater system.*

- *The transfer of responsibilities **should not leave "stranded" stormwater responsibilities** with territorial authorities.*
- *Some **specific issues** (recognising the bespoke nature of many arrangements) will need to be **worked through by the water service entities on case by case basis,** as exceptions to the general application of the design principles.*
- ***Where the Water Service Entity does not own the assets**, they will need to establish an **interface and/or service level agreements or other similar arrangements with key public sector entities***

Rural Drainage

In principle, it was agreed that Rural Drainage would need a Service Level Agreement between the owners, which could be between private properties, The Local Authorities and the Water Service Entities to manage the critical component relating to management of stormwater and conveyance of water through a catchment, noting the predominant function for rural land drainage is to drain the adjacent farm land.

Rural Stock Schemes

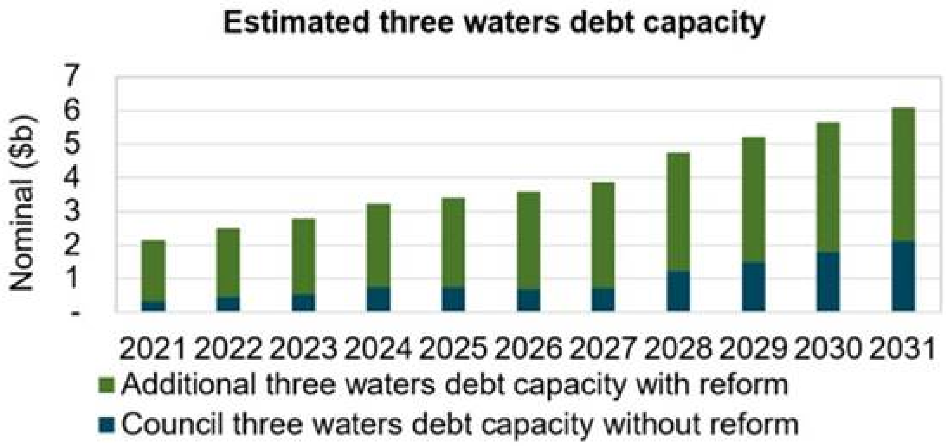
*Water Service Entities will **NOT** manage rural stock schemes, as the benefit is to the farmer/private landowner to manage their stock.*

5. What about private water schemes that fail after the creation of the Entity? It has been suggested that those might fall to local Council's to take on and remedy. How would Council's do that, given their waters teams will have been transferred to the Entity?

An important principle underpinning the service delivery reforms is that councils will not be left with residual services/obligations following the reform and transfer of their assets and expertise. This means that obligations that currently sit with councils to deliver three waters services would transfer to the proposed water services entities. For example, to provide these services following natural disasters/emergencies or as the supplier of last resort for drinking water services to communities. Where necessary/invited, it is anticipated that non-council providers not on council-reticulated services, would have opportunities to enter into mutually agreeable service arrangements with the water entities.

6. What happens if an Entity becomes capital constrained ie the development demands outstrip the ability to source and service the required debt? How will conflicting priorities be managed?

Modelling shows that the entities would have greater borrowing capacity within which to prioritise investment compared to councils alone. Below is a graph depicting the estimated borrowing capacity of entity A, this is plotted against the maximum collective borrowing capacity of all councils within entity A individually without reform.



In setting priorities, the entities would be required to engage in a meaningful and effective manner with their consumers and communities on the preparation of key documents including documents relating to investment prioritisation.
This means consumers and communities with be provided with opportunities to give direct feedback to the entities before any final decisions are made. The entities will then be required to take this feedback into account before finalising the documents.

7. **What sort of revenue model is being considered? A purely flat fee for connection of each of the services? What happens if you are connected to a wastewater scheme but not a drinking water one? Will our current 'capable of connection' charges continue? If not then how will those who are capable of connecting be inspired to take advantage of the service available to them?**

The approach to charging and pricing is still being considered and further work is being undertaken to understand the range of charging mechanisms currently being used by councils and the impact of alternative charging structures. However, it is expected that Water Services entities will have a broad range of mechanisms at its disposal, including all mechanisms currently used by local authorities.
The reform proposals include proposals for the introduction of an economic regulator and Government Policy Statements.

8. **How will the Entity fund growth? Will development contributions continue or is growth to be funded out of revenue and debt? Or will developers be required to build and vest infrastructure (as in the Papakura model)?**

Please see above in relation to charging and pricing.

9. **Is the idea to have a single set of quality standards across the motu? If so then how will that apply to stormwater? For example we have many areas with open drains in urban environments. Will that be allowable in those quality standards?**

Stormwater consents and regulation will continue to be managed through regional councils.

However, The Water Services Bill will make previsions for Taumata Arowai to oversee the compliance of stormwater consents.

In regards to wastewater, the Minister is considering a set of national wastewater standards which would be enforced by Taumata Arowai. Details of these wastewater standards will be released if and when the relevant decisions have been made.

10. **Was a Trust model (aka Northpower) considered? The Northpower Trust is governed by a locally elected Trust Board which would seem to be a way to retain the locally elected aspect while still being able to separate the assets from LG.**

A trust-model is not currently contemplated as part of the Government's reform proposals.

11. **Will the economic regulator be involved with managing economies between entities as well as within? For example Entity A could end up charging more than Entity B. Will this be allowable or are there parameters that will apply?**

Charges and parameters will be worked through as a part of the Economic Regulation discussion document outlined above.

12. **Was the option for LG to borrow directly from CG considered and if it was, why was it discarded?**

The Department's Regulatory Impact Analysis discusses what alternate funding options were considered in detail – see page 65.
In short there are challenges with this model in identifying the revenue source for this funding, furthermore this type of funding often fluctuates with successive government priorities as has been seen with past water infrastructure funding.
Putting more money into the existing system will not allow us to collectively fund the investment needed over the next 30 years, both in terms of correcting potential underinvestment and new investment required to respond to risks like climate change. The reform proposals will create greater efficiencies in terms of delivery – as well as better career paths and ability to retain skilled staff.

13. **How will the effectiveness of the new Entities be measured in terms of are they achieving the promised results?**

The Economic Regulator would ensure there is good service quality for the consumer, the right level of investment, and drive efficiency gains – including a requirement to meet depreciation, protection against inefficiencies and the removal of opportunities for monopoly/excessive pricing. Furthermore, the quality regulators (regional Councils and Taumata Arowai) will have stronger roles in compliance, monitoring and reporting against the performance of the entities.

In addition, as already outlined in question two, the Regional Representative Group would set a Statement of Strategic and Performance Expectations for the water services entity, which would set the specific objectives and priorities for the board of the entity. The board must then take the Statement of Strategic and Performance Expectations into account when producing their Statement of Intent (how they would deliver on the objectives and priorities). The entity would also be required to make public final documents, which would give communities a level of transparency to see how their entity is performing.

14. What is the level of commitment from CG to the ongoing role of LG and locally elected members?

The reforms aim to strengthen the mechanisms for individual consumers and communities to directly influence the entities themselves, through ongoing engagement, reporting and transparency obligations. As one of the key principles of the reform programme is to create separation from council balance sheets, councils will have a reduced level of direct influence over water services provision.

However, the Government has proposed a core role for local government and mana whenua in setting the strategic direction, performance expectations, and oversight of the entities.

Independent competency-based boards will govern the new entities day-to-day management of three waters service delivery.

Going forward the Government is committed to supporting councils to envisage their functions being about place-making and the wellbeing of their communities. In tandem with the Three Waters Reform Programme, the Government aims to strengthen your role as custodians of, and visionaries for, your communities and has launched the Future for Local Government Review to ensure we have robust and fit-for-purpose local government arrangements into the future.

15. How confident is CG that the Entities will in fact be able to access the level of funding suggested? What happens if they can't?

Given the quantum of the financing requirement, we undertook high-level discussions with key capital market participants in order to educate the market about proposed entities and to elicit early-stage feedback around how a financing programme might be structured to support efficient and cost-effective procurement of financing of entities.

This engagement provided some key insights including that the credit profile and associated Standard & Poor's rating (AA+) of the water entities under the scenario similar to the reform proposals would make them an attractive proposition to capital markets investors. The water entities would join a suite of large, highly rated New Zealand borrowers (NZDMO, Kāinga Ora, LGFA and Auckland Council) who access the capital markets in volume and would increase New Zealand's presence in international capital markets providing a wider benefit to New Zealand borrowers.