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Hon Nanaia Mahuta, Minister of Local Government

Proactive release of Cabinet material about three waters service delivery and funding arrangements, 28 January 2020

The following documents have been proactively released:

28 January 2020, CBC-20-MIN-0006 Minute: Three Waters Service Delivery and Funding Arrangements: Approach to Reform, Cabinet Office; and

28 January 2020, Cabinet Paper: Three waters service delivery and funding arrangements: approach to reform, Office of the Minister of Local Government.

Some parts of this information would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act). Where this is the case, the relevant sections of the Act that would apply have been identified. Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to Redaction Codes:

- 9(2)(f)(iv) – maintain the constitutional conventions for the time being which protect the confidentiality of advice tendered by Ministers of the Crown and officials

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Cabinet Business Committee

Minute of Decision

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Three Waters Service Delivery and Funding Arrangements: Approach to Reform

Portfolio **Local Government**

On 28 January 2020, the Cabinet Business Committee, having been authorised by Cabinet to have Power to Act [CAB-20-MIN-0003]:

- 1 **noted** that the case for change to the current structural arrangements for delivery of three waters services continues to build, and that changes to how New Zealand delivers three waters services are required;
- 2 **noted** that there are key decisions that will impact on the design of service delivery arrangements, including:
 - 2.1 the scope of new water service providers;
 - 2.2 the size and scale of the new water service providers;
 - 2.3 the ownership and governance arrangements for the new water service providers;
 - 2.4 how the potential impacts of change on local government can be managed;
 - 2.5 how the performance of new water service providers will be monitored;
- 3 **noted** that there are specific objectives that are important considerations for the development of new service arrangements, including:
 - 3.1 significantly improving the safety and quality of drinking water services, and the environmental performance of wastewater and stormwater systems;
 - 3.2 ensuring that all New Zealanders have equitable access to affordable three waters services;
 - 3.3 improving the coordination of resources and unlocking strategic opportunities to consider New Zealand's infrastructure needs at a larger scale;
 - 3.4 increasing the resilience of three waters service provision to both short and long-term risks and events, particularly climate change and natural hazards;
 - 3.5 moving the supply of three waters services to a more financially sustainable footing, and addressing the affordability and capability challenges faced by small suppliers and councils;

- 3.6 improving transparency about, and accountability for, the delivery and costs of three waters services, including the ability to benchmark the performance of service providers;
- 4 **noted** that in addition to the specific objectives for reform, there are some bottom lines that any changes to service delivery arrangements must meet, including:
- 4.1 protecting public investment in three waters assets;
- 4.2 being consistent with the objectives and operating principles of Taumata Arowai, the Water Services Regulator;
- 4.3 supporting an integrated approach to the development and management of land and water;
- 4.4 providing a customer voice;
- 4.5 accepting that change will have an impact on local government, but limiting the impact as much as possible;
- 5 **noted** that there are a range of potential service delivery models, but that initial analysis indicates that multi-regional and regional models perform best across all the objectives and bottom lines;
- 6 **agreed** that the further work with local government on the design of new service arrangements will focus on multi-regional and regional models for service delivery;
- 7 **agreed** that the government continue to support local government to make voluntary changes to service delivery arrangements;
- 8 **noted** that local government must make progress on voluntary sector-led reforms to service delivery arrangements to ensure the local government sector can respond to the drinking water regulatory reform programme;
- 9 **agreed** to set a one-year deadline, beginning in 2020, by which the local government sector needs to demonstrate that it has made progress with voluntary reform;
- 10 **noted** that the Minister of Local Government will provide further advice on how local government progress will be assessed and determined, but that the Minister is expecting by the end of 2020 that:
- 10.1 most councils will have initiated work to investigate new service arrangements, either within regions or in partnership with other regions;
- 10.2 at least two or three regions will have identified a preferred option, and will be preparing to consult on, or implement new service arrangements;
- 11 **noted** that on 1 July 2019, Cabinet agreed that proposals for support for regions on voluntary changes to water service delivery arrangements be considered on a case by case basis [CAB-19-MIN-0331];
- 12 9(2)(f)(iv)

- 13 **noted** that a three waters infrastructure fund could provide an opportunity to support local authorities to address the three waters infrastructure deficit, accelerate progress on improving drinking water, and support improvements to environmental outcomes;
- 14 **invited** the Minister of Local Government to provide an oral update to the Cabinet Economic Development Committee (DEV), in April 2020, on initial progress with the voluntary, local government sector-led reforms to service delivery arrangements;
- 15 **invited** the Minister of Local Government to report back to DEV, in mid-2020, with:
- 15.1 a report on progress with the voluntary, local government sector-led reforms to service delivery arrangements, and any other actions that may be needed to support voluntary reform;
 - 15.2 advice on a possible national three waters infrastructure fund;
 - 15.3 advice on a work programme to support further analysis of aggregated multi-regional and regional service delivery models, should this approach be needed;
 - 15.4 advice on whether further work on a dedicated economic regulation regime is warranted in light of progress made on voluntary, local government led reforms to service delivery arrangements;
- 16 **noted** that local authorities are already required by the Local Government Act 2002 to report on financial and non-financial performance, including measures relating to three waters services, and that there is potential to make better use of these mechanisms;
- 17 **directed** the Department of Internal Affairs, in consultation with the Ministry of Business, Innovation and Employment, to explore whether the existing three waters performance measures referred to in paragraph 16 above can be revised to provide better information on the quality of three waters services being delivered to New Zealanders;
- 18 **noted** that it is intended that the work referred to in paragraphs 15 and 17 will be undertaken in partnership with local government, and that a local government reference group will be convened to develop the advice on these matters;

Monitoring and stewardship arrangements

- 19 **noted** that on 30 September 2019, Cabinet:
- 19.1 made a number of decisions about the organisational form and remit of a new Water Services Regulator;
 - 19.2 noted that there would need to be further consideration about what these decisions mean for the location of policy advice, monitoring, and system stewardship functions, as well as Ministerial portfolio responsibilities;

[CAB-19-MIN-0506]

- 20 **noted** that the Minister of Local Government is developing a proposed approach to the matters referred to in paragraph 19 above, for discussion with the Minister of Health, Minister for the Environment, and Minister of State Services in early 2020;

- 21 **invited** the Minister of Local Government to report back to DEV in April 2020 to confirm arrangements for:
- 21.1 policy advice, monitoring, and portfolio responsibilities relating to the new Water Services Regulator;
 - 21.2 monitoring, oversight and stewardship of the three waters system more broadly.

Vivien Meek
Committee Secretary

Present:

Rt Hon Jacinda Ardern (Chair)
Rt Hon Winston Peters
Hon Kelvin Davis
Hon Grant Robertson
Hon Phil Twyford
Hon Dr Megan Woods
Hon Chris Hipkins
Hon Andrew Little
Hon Carmel Sepuloni
Hon Dr David Clark
Hon David Parker
Hon Nanaia Mahuta
Hon Jenny Salesa
Hon Kris Fafoi
Hon Tracey Martin

Hard-copy distribution:

Minister of Local Government

Officials present from:

Office of the Prime Minister
Department of the Prime Minister and Cabinet

Office of the Minister of Local Government

Chair

Cabinet Economic Development Committee

Three waters service delivery and funding arrangements: approach to reform

Proposal

1. This is the fourth in a series of papers on the Three Waters Review to be considered in 2019. It sets out an approach to working with local government to transition the sector to new three waters (drinking water, wastewater and stormwater) service delivery arrangements.

Executive summary

2. Three waters infrastructure and services are lifeline utilities that provide essential services to communities. A lack of regulatory oversight, infrastructure underinvestment and capability constraints have meant that, in many parts of the country, consumers cannot be certain their water is safe to drink, or that the three waters system is contributing to good environmental or regional development outcomes.
3. In November 2018, Cabinet agreed the Government would embark on comprehensive reforms to the three waters system, prioritising regulatory reform before considering changes to service delivery arrangements [CAB-18-MIN-0545 refers]. Since then, we have made significant progress on the regulatory reforms and have agreed to proceed with:
 - 3.1 system-wide reform of drinking water regulation;
 - 3.2 targeted reform of wastewater and stormwater regulation; and
 - 3.3 the establishment of a Water Services Regulator.
4. These reforms are to be implemented through legislation in 2020. It is now time to consider three waters service delivery and funding arrangements.
5. There are two key themes that sit at the heart of the challenges facing New Zealand's three waters service delivery: affordability and capability. The cumulative effect of increasing capital and operating costs to meet infrastructure challenges, and constrained sector capability to address key public health and environmental challenges, confirm the status quo is not sustainable. These challenges are particularly acute for smaller council and non-council drinking water suppliers, with smaller ratepayer and consumer funding bases.
6. Other countries have faced similar challenges and, in response, have made changes to the way they deliver water services. This paper draws on the experience of those countries to describe potential three waters service delivery models, and how they could be designed to address the issues and concerns that have been raised about changing our current service delivery and funding arrangements.

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7. New Zealand also needs to rethink how it provides three waters services to address our affordability and capability challenges. There are opportunities for the Government to partner with the local government sector to build a consensus about those future service delivery and funding arrangements.
8. Local government provides drinking water to most New Zealanders¹, and owns and operates all municipal wastewater systems. A key objective of my approach to transition to new water service delivery arrangements is to build the capacity and capability of the local government sector to lift its overall performance and support both small council and small non-council drinking water providers.
9. Local councils have recognised the need to address the wider affordability and capability challenges facing the three waters sector. Cabinet has agreed to consider proposals for support from the regions on voluntary changes to water service delivery arrangements should be considered on a case by case basis [CAB-19-MIN-0331 refers].
10. However, implementing voluntary reform is difficult and there are a range of technical, political and financial barriers to overcome. A partnership approach, between central government and local government, is needed to address these challenges.
11. This paper sets out my proposed approach to supporting local government to transition towards new service delivery arrangements, to ensure all communities benefit from safe, affordable, and reliable three waters services. My approach has three key elements:

11.1 A timeframe for making progress towards changes in service delivery arrangements. I am proposing that by the end of 2020 local government should be able to demonstrate that they have made progress on investigating new service arrangements. My expectation is that most councils will have begun to investigate changes in regional groupings, and at least two to three regions will have identified a preferred option and are preparing to consult on, or be about to begin the implementing new service arrangements

11.2 Funding to support transition to new service arrangements. While Cabinet has agreed to receive applications for financial support from regions that wish to voluntarily *investigate* service delivery changes, it is likely that further financial support will be needed to support regions to *implement* new service delivery models. 9(2)(f)(iv)

There may also be wider opportunities to consider how national funding could enable the country to accelerate progress on addressing key infrastructure and operational issues and incentivise service delivery improvements.

¹ Eighty-seven per cent of our population receives drinking water from local authorities. Office of the Controller and Auditor-General. *Local authorities: Planning to meet the forecast demand for drinking water*. February 2010.

- 11.3 Consideration of legislative creation of new water service providers.** My preference is to work in partnership with the sector as it considers voluntary changes to identify what legislative changes may be required to support the adoption of new service delivery models, and/or identify if there is a potential service delivery model that could be implemented through legislation with voluntary support.
12. The timeframe to consider, develop and implement new service models is challenging. This will mean that all the workstreams above will need to be advanced in parallel, in partnership with local government, to ensure that the sector can make progress towards sustainable service delivery arrangements.

Background

13. In November 2018, we considered a range of challenges facing the three waters regulatory and service delivery system. We concluded there was a clear case for change because of the following issues:
- 13.1 Weaknesses across the regulatory system.** Both drinking water and environmental regulation exhibit, in differing degrees, inadequate stewardship, leadership, and compliance, monitoring and enforcement practices. The specific issues are explained in my July 2019 Cabinet paper, *Strengthening the regulation of drinking water, wastewater and stormwater* [CAB-19-SUB-0332 refers].
- 13.2 Funding and financing challenges.** Affordability issues and financial pressures mean that many councils are struggling to fund plant and pipe infrastructure to the level required to keep pace with population growth, environmental standards, community aspirations, and the need to build resilience against natural events. Affordability challenges are particularly acute for smaller communities, rural and provincial councils, non-council drinking water suppliers, and marae, who are all finding it difficult to afford quality infrastructure and services.
- 13.3 Capability and capacity challenges.** Good capability is needed to lift the public health and environmental performance of the three waters sector. Specialist skills are required to design, procure, deliver and manage three waters services. However, it is often difficult for smaller councils and service providers to develop the capabilities required, and to access and retain people with specialist skills. These challenges tend to be greater for smaller rural and provincial councils, and non-council drinking water suppliers (such as small private and community schemes, and marae).
14. Cabinet agreed the Government would embark on comprehensive reforms to the three waters system, but would prioritise regulatory reform before considering changes to service delivery arrangements [CAB-18-MIN-0545 refers].

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15. I have been leading this work, with support from Ministers with portfolio interests in three waters regulation and infrastructure, in particular the Minister of Health and the Minister for the Environment. In July 2019, I set out my plan for three waters reform starting with delivery of our priority to strengthen the regulation of drinking water, wastewater and stormwater [CAB-19-SUB-0331 refers]. Since then, we have made significant progress on the regulatory reform programme, and have agreed to:
 - 15.1 system-wide reforms to drinking water regulation;
 - 15.2 targeted reforms to wastewater and stormwater; and
 - 15.3 the creation of a new Water Services Regulator to administer and enforce the new regulatory system.
16. In this paper, I focus on our next priority – the reform of three waters service delivery and funding arrangements.

Summary of the challenges facing three waters providers

17. Strengthening the three waters regulatory system will place greater emphasis on compliance with legislation and standards. Nationally, the estimated capital costs of upgrading networked drinking water treatment plants to meet drinking water standards is between \$309 million and \$574 million, with an additional annual operating cost of \$11 million to \$21 million.² These costs do not include the potential costs of including very small suppliers, specified self-suppliers and rural schemes in the regulatory system, which could be between \$190 million to \$551 million.³
18. Most larger councils and government agencies⁴ that provide drinking water will be able to meet the potential costs associated with the new drinking water regulatory requirements, and are already planning for this expenditure as part of their long-term plans and budget planning processes.
19. However, as I noted in my July 2019 paper, *A plan for three waters reform*, it will be challenging for some service providers, particularly for smaller rural and provincial councils, and non-council drinking water suppliers (such as small private and community schemes, and marae), to meet the cost of the new regulatory requirements.
20. To ease this burden, the Water Services Bill (to be introduced in early 2020) proposes a five-year transition period within which smaller suppliers would need to become compliant with all aspects of the new regulatory regime. While this will provide enough time for some providers to upgrade their facilities, there will be others that will find this timeframe challenging. During the establishment phase for the new Water Services Regulator, additional analysis to identify the number, types and risk-profiles of small suppliers will increase the understanding of the regulatory requirements and transition issues for those small suppliers.

² Beca: *Cost estimates for upgrading water treatment plants to meet potential changes to the New Zealand Drinking Water Standards*, March 2018.

³ Beca: *Additional Analysis on Drinking Water Cost for Compliance*, November 2019.

⁴ In particular, the Department of Conservation, Department of Corrections, Ministry of Education, and New Zealand Defence Force.

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21. While the proposed new drinking water regulatory requirements may mean that some small suppliers need to upgrade infrastructure, the first step for many will be building their capability to manage their drinking water supply. An evaluation of the Drinking Water Assistance Programme, and the Sanitary Works Subsidy Scheme, identified that, while the funding was successful in enhancing the infrastructure in socio-economically deprived communities, the capacity and capability of those communities to manage the ongoing maintenance and operation of that infrastructure was highly variable.⁵
22. Local authorities will have an important role to play in supporting these small suppliers because of their existing capability and their connections to the communities these suppliers service. This task will be challenging for small councils. A key objective of my approach to transition to new water service delivery arrangements is to build the capacity and capability of the local government sector to support both small council and small non-council drinking water providers.
23. Councils will also face challenges to upgrade wastewater infrastructure. Research into the costs of upgrading wastewater treatment systems to meet potential national standards for freshwater and coastal discharges identified that the indicative costs of upgrading all wastewater treatment systems over the coming years falls within a range of \$3.0 billion to \$4.3 billion, with an additional annual operating cost of \$126 million to \$193 million.⁶
24. A significant portion of the costs to upgrade wastewater treatment systems will fall over the next decade. Just over 150 wastewater discharges from wastewater treatment plants will need new resource consents over the next 10 years.⁷ Upgrades to treatment plants are likely to be required to meet new consent requirements. The potential costs of those upgrades could be up to \$2.0 billion⁸, with the costs of re-consenting estimated to be in the order of \$100 million.
25. Many rural councils and their communities are struggling to meet the costs of upgrading wastewater treatment plants. The relative costs of wastewater upgrades for metro, provincial and rural councils create an affordability challenge for small, mostly rural councils. This affordability challenge is highlighted in the graph below.

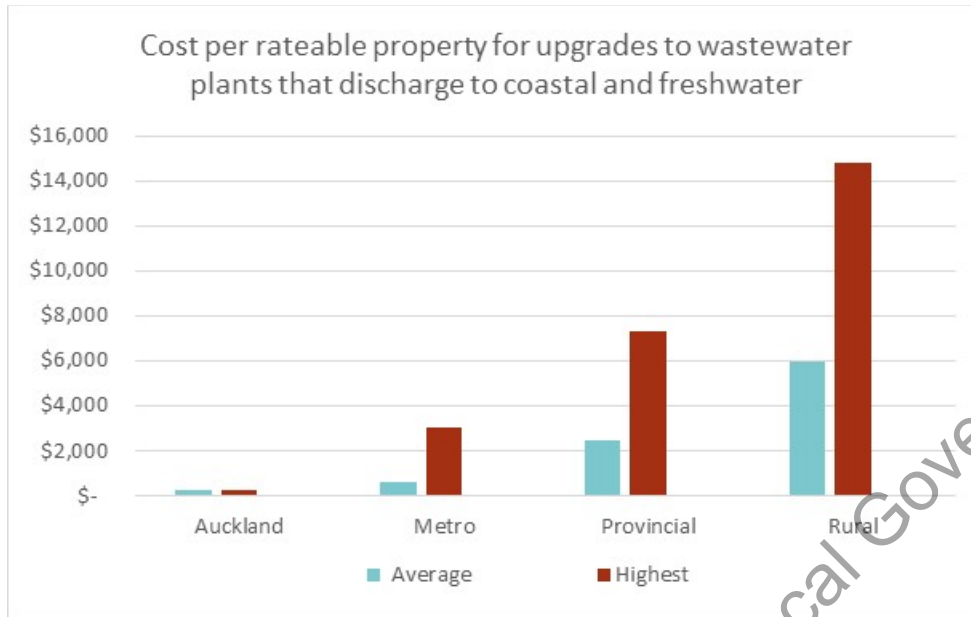
5 Allen+Clarke. *Evaluation of the Drinking Water Assistance Programme; With updates and Analysis of the Sanitary Works Subsidy Scheme*. 30 August 2017.

6 GHD, Boffa Miskell. *Cost estimates for upgrading Wastewater Treatment Plants to meet Objectives of the NPS Freshwater -2019*; GHD, Boffa Miskell. *Cost Estimates for upgrading Wastewater Treatment Plants that discharge into the Ocean*. November 2019.

7 GHD, Boffa Miskell. *National stocktake (regulation) of Municipal Wastewater Treatment Plants*, November 2019.

8 An estimate based on costs estimates developed by GHD, Boffa Miskell in reports referred to above.

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26. Estimates of the drinking water and wastewater costs do not include costs of renewing the reticulation network. Reliable information about the condition of the reticulation network is difficult to obtain. The advice my officials have received from other jurisdictions suggests that the cost of addressing existing infrastructure deficits is likely to increase as information about the reticulation network is improved. This view is supported by the relative asset value of plant and reticulation network. Department of Internal Affairs analysis of local authority annual reports identifies the asset value of wastewater treatment plants at \$20 billion and reticulation network at \$80 billion.
27. Climate change will also continue to create further pressure on council balance sheets. Local Government New Zealand's recent report⁹ into the quantum of local government infrastructure exposed to sea level rise estimates that \$4 billion of three waters infrastructure is exposed to a 1.5 metre sea level rise. Further investment will also be required to provide more water storage and upgrade the reticulated network to cope with more intense rainfall events.
28. Natural hazards will continue to create an ongoing risk for both the Crown and local government. The ability of local authorities to respond to those short-term shocks is likely to be limited. Central government is likely to assist, but the costs can be significant. For example, the cost to the Crown of rebuilding three waters infrastructure in Canterbury following the 2010/11 earthquakes was around \$940 million.¹⁰
29. The cumulative effect of these costs and the lack of capability confirm that the status quo is not sustainable. I consider that changes to how three waters services are delivered is required to address these challenges. While there is time to consider new service arrangements, there is urgency to act because:

9 Tom Simonson and Grace Hall, Local Government New Zealand. *Vulnerable: The quantum of local government infrastructure exposed to sea level rise*. January 2019

10 Controller and Auditor-General. *Roles, responsibilities, and funding of public entities after the Canterbury earthquakes*. 2012. Part 3.

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- 29.1 without addressing the weaknesses in the structural arrangements that local authorities currently use to deliver three waters services, the objectives of our three waters regulatory reform programme (including the effectiveness of the new Water Services Regulator) may be undermined;
- 29.2 without addressing the existing infrastructure inadequacies affecting the performance of the sector, the costs of resolving these issues will continue to increase;
- 29.3 any change in service arrangements will have a disruptive impact on existing infrastructure upgrades and take at least two years to implement;
- 29.4 almost half of wastewater treatment plants are expected to be reconcented within the next 10 years, creating a time-imperative opportunity for a more effective and efficient investment strategy for wastewater infrastructure upgrades.

Comment

- 30. Now that key decisions on the regulatory framework have been made, it is time to re-engage with issues that affect how three waters services are delivered and funded. There are two key questions:
 - 30.1 What does “good” look like, or what are the key components that support the development of sustainable water service delivery arrangements?
 - 30.2 What is the pathway for the local government sector to transition to new delivery arrangements that provide safe, affordable, and reliable three waters services?
- 31. The discussion on how three waters services are delivered and funded is set out in two parts. Part A describes a range of potential options for new water service arrangements, and key considerations that will influence the design of these arrangements. I am not seeking final decisions on what the future service arrangements should be in this paper.
- 32. Further work is required to develop detailed policy advice on service delivery models. I propose, in the first instance, to work with the local government sector to develop this advice and identify how it can be used to support the transition to new service delivery arrangements. I am proposing to provide an update on progress in mid-2020.
- 33. Part B considers how the local government sector could be supported to make voluntary changes to new service arrangements through the transition pathways that I have previously identified:
 - 33.1 regulatory reform only, with voluntary, sector-led reforms to service delivery arrangements;
 - 33.2 establishment of a three waters fund to support voluntary service delivery improvements; and
 - 33.3 creation (in legislation) of an aggregated system of dedicated, publicly-owned drinking water and wastewater providers.

34. My initial focus is on supporting local government to make voluntary changes to transition the sector to sustainable water service delivery arrangements, building from successful initiatives to create a consensus for change.
35. However, I acknowledge that voluntary reform is difficult, and local government will require ongoing support to be successful. My transition approach is focused on supporting local government to progress towards sustainable service delivery arrangements, by setting a clear timeframe for progress towards change, considering further central government funding support, and continuing to investigate the legislative barriers and opportunities that would enable the creation of new water service providers.
36. Following this discussion, the final section of this paper provides advice on monitoring and stewardship arrangements for the three waters system and Water Services Regulator.

Part A: What are the key components of sustainable water service delivery arrangements?

There are a range of models for service delivery

37. Local government ownership and management of three waters services has been a common approach to the delivery of three water services in New Zealand and many similar countries. However, as regulatory requirements have become tougher, and community expectations have increased, the capacity and capability shortcomings of a system that has many small local government providers has become apparent.
38. This has led countries like Scotland, England, Ireland and Australia to reform their service delivery arrangements for three waters. Noting the range of potential models that have been adopted in those countries, I consider that three potential models for service delivery reform merit further consideration in this country:
 - 38.1 one national, publicly-owned water provider delivering water services across New Zealand;
 - 38.2 three to five multi-regional, publicly-owned water providers delivering water services across multiple regions; and
 - 38.3 regional, publicly-owned water providers delivering water services within regional boundaries.
39. Each model has different strengths and weaknesses. However, there are opportunities to address the weaknesses and to enhance the performance of specific models through their design. Some of the key design considerations are set out below.

Key considerations affecting the design of future water service delivery arrangements

40. The reform of regulatory regimes and service delivery arrangements is interconnected. In previous papers, I have identified high-level objectives for three waters reform. However, there are specific objectives that are important considerations for developing new service arrangements. These include:
 - 40.1 significantly improving the safety and quality of drinking water services, and the environmental performance of wastewater and stormwater systems;

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- 40.2 ensuring that all New Zealanders have equitable access to affordable three waters services;
 - 40.3 improving the coordination of resources and unlocking strategic opportunities to consider New Zealand's infrastructure needs at a larger scale;
 - 40.4 increasing the resilience of three waters service provision to both short and long-term risks and events, particularly climate change and natural hazards;
 - 40.5 moving the supply of three waters services to a more financially sustainable footing, and addressing the affordability and capability challenges faced by small suppliers and councils; and
 - 40.6 improving transparency about, and accountability for, the delivery and costs of three waters services, including the ability to benchmark the performance of service providers.
41. In addition to the specific objectives for reform, there are some "bottom lines" that any changes to service delivery arrangements must meet. These include:
- 41.1 protecting public investment in three waters assets;
 - 41.2 being consistent with the objectives and operating principles of Taumata Arowai—the Water Services Regulator;
 - 41.3 supporting an integrated approach to the development and management of land and water;
 - 41.4 providing a customer voice; and
 - 41.5 accepting that change will have an impact on local government, but limiting the impact as much as possible.
42. Before considering the performance of different service delivery models against these objectives and "bottom lines", there are some key decisions that will influence the specific design of any model. Identifying our preferences on those design choices will enable further detailed investigation of those specific design features to be undertaken.

What could be the scope of new water service providers?

- 43. In other jurisdictions¹¹, it is common for water entities to be responsible for drinking water and wastewater services, but not stormwater management. Stormwater has largely remained the responsibility of local government. In New Zealand, this approach was adopted in Auckland, where Watercare delivers drinking water and wastewater services, while Auckland Council continues to manage stormwater.
- 44. While there are strong interconnections between all three waters that should continue to be maintained, my view is that new service providers should focus on drinking water and wastewater, at least initially. Key advantages of this approach are that it would:

¹¹ Including Scotland, England and Wales.

- 44.1 Prioritise drinking water and wastewater service improvements.** While the challenge to improve stormwater quality and management is important, the requirement to improve drinking water and wastewater is well understood, and immediate. Compliance with drinking water standards is a public health priority, and many small councils have capacity and capability challenges that affect their ability to meet the regulatory requirements. There is also a significant task (and opportunity) over the next decade to consent and upgrade almost half of our wastewater treatment plants.
- 44.2 Maintain a strong connection between land use planning.** While drinking water and wastewater systems are directly linked, stormwater networks are more often a mix of open drains and hard infrastructure. Much of the stormwater network is provided through the roading system and has strong links with land use. Solutions to reducing impacts of stormwater need significant council input and action as they lie across a range of areas and council functions, including planning, urban design, community engagement and consumer behaviour.
45. Focusing on “two waters” does not mean that we cannot continue to improve stormwater quality. Most wastewater systems have been designed to overflow into the stormwater system when there is heavy rain. Both those stormwater and wastewater overflows will continue to be regulated by regional councils, so collaboration between water service providers and councils would still be required to manage the impacts of wastewater overflows.
46. Future service delivery arrangements could also enable councils to contract water service providers to deliver aspects of local stormwater services. This would allow them to take advantage of procurement and engineering skills that would exist in new water organisations, but leave councils in control of the connections between stormwater, roading and urban planning. As the connections between new service providers and councils consolidate, there would be further opportunities to revisit the inclusion of stormwater in the future.
47. Another option would be to create sole purpose drinking water organisations. This option has risks. Firstly, it is likely to be just as complex to create dedicated drinking water providers as it is to create providers covering both drinking water and wastewater services. Secondly, splitting capability between dedicated drinking water providers and councils could exacerbate existing capability problems. This is a particular risk for small to medium sized councils that already face capability and capacity challenges.

What could be the size and scale of new water service providers?

48. The size and scale of new service providers is the key difference between the range of potential service delivery models, and will have a significant impact on providers' financial capacity and capability to deliver water services. Larger water service providers could:

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- 48.1 Increase financial capacity and capability.** More customers, a larger revenue catchment, and the ability to cross-subsidise would provide water service providers with stronger balance sheets and greater flexibility to direct significant investment to where it is needed. A stronger balance sheet would improve the resilience of new water service providers, enabling them to finance the catch-ups required, and respond to short-term shocks like earthquakes, and long-term challenges like climate change.
- 48.2 Increase investment scale.** Currently within any catchment there could be several district and city councils, all making individual decisions to fund and upgrade water infrastructure. In the context of the significant wastewater investment programme required over the next 10 years, increases in scale create an opportunity to consider the best investment across boundaries. This could also enable new water service providers to rationalise existing water infrastructure and invest in new infrastructure where it can make the most impact.
- 48.3 Build technical capability.** Increasing the size and scale of water service providers would enable the industry to build technical capability and attract talent. Watercare and Wellington Water demonstrate the lift in capability that is possible with larger providers. Larger providers can attract and retain specialist staff, such as microbiologists, water engineers, data specialists, and dedicated community engagement staff, and provide career pathways for people entering the water industry.
- 48.4 Enable financial efficiencies.** Consolidating administration and overhead costs, and improving organisational and technical capability, can enable more efficient delivery and lower the operating costs of providing water services. While some of those cost savings would be balanced against increases in capital expenditure to address the likely backlog of under investments, the cost savings attributable to those financial efficiencies could result in lower water charges, relative to what they would otherwise have been.
- 48.5 Enable more consistent water charges.** A common feature of many water service reforms has been a move to harmonise tariffs across the new service areas. In Scotland, which has one national provider, there is agreement that similar properties should pay the same amount for water services. In Auckland, when Watercare was established, all water charges were harmonised so that each community paid the same \$1.30 per unit for water services across Auckland. This process meant tariff reductions ranging from 0.6 per cent in Manukau City to 62.9 per cent in the rural Rodney District.
- 48.6 Unlock strategic opportunities.** Larger service providers can unlock strategic opportunities to take a more coordinated approach, and consider our infrastructure needs at a larger scale. This has been the case in Auckland, where Watercare is building the \$1.2 billion Central Interceptor to improve the quality of Auckland waterways. It is unlikely this would have been possible under the previous six Auckland councils.

What could be the ownership and governance arrangements for new water service providers?

49. As previously agreed by Cabinet, the protection of the significant public investment in existing three waters assets and services is a “bottom line” for any reform of service delivery ownership arrangements [CAB-18-MIN-0545 refers]. Currently, public ownership occurs through the direct ownership of three waters assets by councils. The local government sector has argued strongly that local ratepayers' investment in infrastructure assets should not be transferred.
50. If larger water service providers are established, collective ownership by councils is possible under any service delivery model. The collective local authority ownership model has been shown to work effectively in Tasmania, where local authorities continue to own the three waters infrastructure through an equity shareholding in the service provider, Taswater. Taswater is managed by a professional board appointed by a subcommittee of the Owners Representatives Group. Key corporate documents, such as the Statement of Intent, are developed in consultation with the Owners Representatives Group.
51. Professional governance arrangements, and the specialist expertise this brings, are essential to create some of the capability improvements that are required. Currently, in most regions, the governance of three waters assets are undertaken by councillors. Separating ownership and governance roles and responsibilities is an essential requirement for service delivery reform. These arrangements are not unusual, and both Watercare and Wellington Water are examples of council-controlled organisations that maintain local government ownership, but have professional governance arrangements.
52. A key consideration for ownership structures is the impact on service providers' ability to fund investment through debt. Debt funding infrastructure ensures that intergenerational costs and benefits are shared between current and future consumers. However, the level of borrowing by New Zealand councils is being constrained by behavioural and mandated factors. If local authorities retain asset ownership, this could limit the ability of the water service providers to borrow, with debt limits either constrained by council debt limits, or attitudes to debt. More work is needed to identify how to address these barriers. However, equity ownership arrangements, where no single council has control of the new water entity, can help to separate the funding and financing arrangements of the council owners from the new water service provider.
53. A local government ownership model could also include transfer of responsibility for service delivery to regional councils. Regional council ownership would mean that ownership would stay within the same “family” of ratepayers. However, regional councils have limited service delivery experience, and some regions lack the scale and resources to address funding and capability challenges. This option is also unlikely to be supported by local government.

How can the potential impacts on local government be managed?

54. The local government sector has several concerns about the impact of any transfer of the responsibility for the provision of water services from councils to new water service providers. Factors to consider include:

- 54.1 Loss of control over local services and reduced community input.** The challenge is how to balance local input with the provision of efficient and effective services. In Australia, where there has been significant aggregation of water service providers, governance arrangements place specific obligations on water service providers to support council and community engagement. In Victoria this is set out in a *Statement of Obligations*, while in Tasmania a shareholders' *Letter of Expectations* enables the local government owners to set their expectations for how Taswater should respond to community interests.
- 54.2 Wider financial impacts of losing water revenues.** While the transfer of assets would remove the obligation to fund the costs of upgrades, and meet the ongoing maintenance and operation costs, local government is concerned that the loss of three waters assets and services from local council operating budgets would compromise their ability to deliver other council activities. However, there are opportunities to mitigate the financial impact of any transfer in the short or long term. In Tasmania, the 29 local authorities were all allocated an equity share in Taswater based on the relative value of the assets and debts that were transferred. Taswater provides an annual dividend to each local authority based on their equity. An equity ownership model can also provide flexibility. Recently, Taswater's local authority shareholders agreed to reduce their dividend to increase the contribution to the capital investments programme.
- 54.3 The impact on local employment.** Local authorities are also concerned about the impact that transferring water services may have on local employment. While consolidating administration and some technical functions contributes to the efficiency of all the potential service models, experience in other countries has been that a "hub and spoke" approach would still be required. Local service arrangements continue to be used to ensure that staff are based locally to operate treatment plants, respond to call-outs and manage local contracts. The "hub and spoke" model would also allow local staff to benefit from specialist support, career development, and training opportunities that may be more limited in smaller organisations.

How can the performance of new service providers be monitored?

55. Unlike other infrastructure sectors with strong monopoly characteristics, the three waters sector has been subject to minimal central government oversight. When Cabinet decisions to establish a Water Services Regulator are implemented, the new Regulator will provide oversight of the drinking water regulatory system and the environmental performance of wastewater and stormwater networks. However, currently there is no provision for economic regulation to identify and report on whether investment levels, asset management practices, service quality, and the prices charged for water services are in the long-term interests of consumers.

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56. A core feature of dedicated economic regulation regimes is the ability to benchmark the performance of water service providers to identify what levels of service and water charges are acceptable for consumers. The current variability of three waters service delivery arrangements, in which the majority of services are provided by unitary, city and district councils, and Watercare and Wellington Water, makes it difficult to implement an economic regulation regime to protect consumers' interests in a cost-effective manner.
57. I am also aware of the significant compliance costs that implementing a dedicated economic regulation regime would impose on water suppliers, at the same time as we are encouraging voluntary service delivery reforms and implementing substantial reforms of drinking water, wastewater and stormwater regulation. I propose pausing work on a dedicated economic regulation regime to allow the sector time and space to explore voluntary service delivery reforms and adapt to our wide-ranging regulatory reforms.
58. I intend to report back to Cabinet Economic Development Committee in June 2020 on the progress of voluntary service delivery reforms. This would include advice on whether economic regulation work should recommence, if I am not convinced that the interests of consumers are being adequately advanced through voluntary reform.
59. In the interim, I consider that there is potential to make better use of existing local government performance information to improve transparency. Local authorities are already required by the Local Government Act 2002 to report on financial and non-financial performance measures, including measures relating to three waters services. I propose that the Department of Internal Affairs, in consultation with the Ministry of Business, Innovation and Employment and the local government sector, explores whether the existing three waters performance measures can be revised to provide better information on the quality and cost of three waters services being delivered to New Zealanders.

Analysis of different service delivery models

60. The following section provides a high-level description of how three potential service delivery models could address the above considerations.

Model 1: one national, publicly-owned water provider

61. This model was adopted in Scotland. One national water entity creates the greatest opportunity to capture all the benefits of increasing the size and scale of water service providers. It could be self-funding, enable the delivery of a national investment programme for drinking water and wastewater upgrades, and deliver a consistent national "price" for water services.
62. With the greatest potential to accelerate progress on improving drinking water, and environmental priorities, a large national provider would also be well placed to take advantage of new technology, such as energy production from wastewater plants, and meet goals such as a carbon neutral approach (something Scottish Water is now tasked with).

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63. While collective local authority ownership is possible in a national model, the number of council owners would make it challenging to reflect their regional interests. However, depending on ownership arrangements, it could leverage greater debt than the other models described below.
64. One national provider is likely to increase the perception that local communities have limited control over assets, although there are opportunities to create consumer protections and enable community input.
65. One national provider would also mean that there was only one employer for water professionals, which may limit the range of opportunities and overall impact on building sector capability.
66. A single national provider would also create challenges if we want to introduce economic regulation. While there are opportunities to improve transparency, monitoring performance, it will not be possible to benchmark a national provider's performance. This means it will be harder to know how well the national provider is or could be performing.

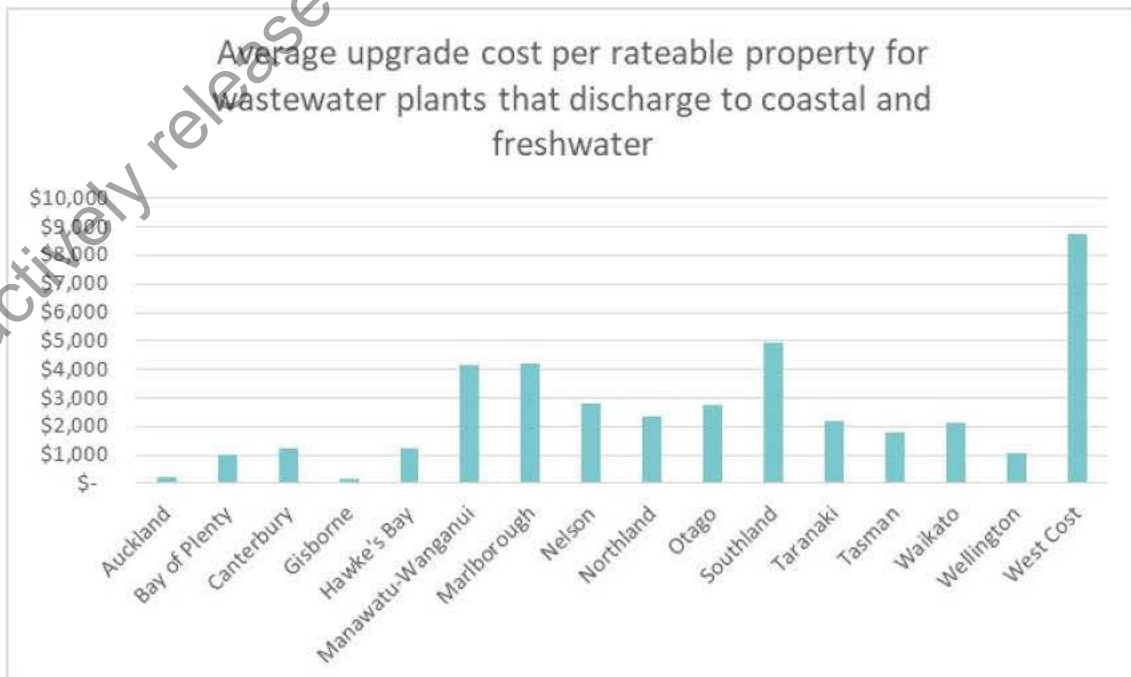
Model 2: three to five multi-regional, publicly-owned water providers

67. Multi-regional water service providers of similar size and scale could be established, with each provider having at least one major metropolitan centre within its area. This means that they would have the capacity and capability to be self-funding, delivering a significant investment programme, and accelerating progress on improving drinking water and/or environmental priorities. They are also likely to have the capacity and capability to develop and adopt new technologies.
68. Multi-regional water service providers would result in significantly less national variation in price and levels of service throughout the country. While there are likely to be some differences in the costs of services, the relatively equal size of the water entities could support a potential transition towards the national alignment of price and levels of service.
69. This model could enable collective territorial authority asset ownership. Multi-regional service delivery models could also have enough financial strength to be able to provide an efficiency dividend to owner councils, as is done in Tasmania.
70. Several similar-sized providers would enable benchmarking of performance and a more efficient regulatory system, with fewer entities for the new regulator to oversee. It would also give water professionals a range of potential employers to choose from.
71. Although there would still be challenges reflecting local identity, and concerns about the effects on local employment and control of services, multi-regional water providers would have stronger regional presence. The connection between the provider "hub" and local delivery "spoke" is also likely to be more visible.

Model 3: regional, publicly-owned water providers

72. Regional water providers could aggregate existing local government water infrastructure and services within existing regional boundaries. Collectively owned by the local authorities in each region, they could operate at "arm's length", with professional governance arrangements.

73. This kind of arrangement already occurs in Auckland and parts of Wellington. Watercare and Wellington Water are both council-controlled organisations with professional governance boards. However, they have significant differences in their operating models.
74. Watercare controls and operates all the drinking and wastewater assets and services across Auckland. It directly charges customers for water services. The ability to spread costs across the region, and make trade-offs between capital investment in asset upgrades and operating expenditure, has enabled Watercare to make substantial capital investments and prioritise upgrade investment based on need.
75. Wellington Water is a shared-service council-controlled organisation that manages and operates drinking water and wastewater assets and services for its council owners. However, each of the councils continue to own water assets and raise revenue (on advice from Wellington Water) for the operation, maintenance and, where necessary, the upgrade of those assets. Wellington Water has no ability to make trade-offs between operating and capital expenditure, nor can it cross-subsidise between owners or ratepayers in different districts.
76. Alignment of regional providers with freshwater catchments would enable decisions to be made on a “best for catchment” basis, and provides the strongest connection to the community and iwi interests in catchment management and protection. The alignment with regional boundaries also provides the strongest connection to an existing community of interest.
77. While regionalising water services could allow costs to be shared between urban and rural areas, mitigating the costs for rural communities, it does not address the affordability challenges for all regions. Regions with low density or no large urban base and a relatively small ratepayer base would continue to face affordability challenges. This is illustrated in the graph below, which identifies the costs per ratepayer in each region for the capital costs of wastewater upgrades.



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78. There is a risk that rural regional water service providers with smaller populations will struggle financially and continue to underinvest in three waters infrastructure. This increases the likelihood that, in time, the Government would need to step in and provide funding support. Smaller regions are also less likely to be able to take advantage of new technologies, or meet goals such as carbon neutrality, without external support (most likely from central government).
79. The significant difference in the size and scale of different regional water service providers would make benchmarking difficult. There are also likely to be higher regulatory costs due to the significant number of providers and the large variation between them.

Developing a future model for service delivery

80. The three models outlined above have different strengths and weaknesses. A key trade-off between the models is the impact that increasing scale and size has on lifting service providers' financial and technical capacity and capability, compared to the potential impacts on the ability of local government and the community to influence and have input into the operation of the larger water service providers.
81. The ability of one national provider, or three to five multi-regional providers, to coordinate significant resources and operate across a large customer base provides them with the greatest opportunity to be self-funding and build the capability to accelerate progress on improving drinking water quality and environmental outcomes. While some regional water service providers could achieve those scale benefits, regional water providers in rural regions are unlikely to be financially sustainable without external funding support.
82. One national water services provider or a multi-regional provider would create more opportunity to create consistent and affordable access to water services. However, one national provider is likely to raise significant concerns from local government, Māori, and the wider the community about the loss of local control and influence. While still likely to be a concern for multi-regional providers, there are more opportunities to provide connection to local government and communities through ownership and service arrangements. Regional water providers represent the smallest change from the existing arrangements and would have the least impact on local government.
83. While further work is needed to fully understand the practical implications of adopting any specific model, the model of three to five multi-regional providers appears to perform best across all the objectives and bottom lines set out in paragraphs 41 and 42.
84. At this stage, my intention is to direct my officials to focus more effort on consideration of both multi-regional and regional service delivery models, and to work with Ministers to develop a view on a preferred service delivery model. I am not proposing to progress further work on a national model at this stage.
85. There is also an opportunity to work with the local government sector to identify a potential model or models that could support voluntary transition to new service arrangements. The outcome of this work could be used to create guidance for the sector, or could be used to develop a model that can be nationally implemented through legislation.

86. I am proposing to provide further advice on a work programme to progress the development of multi-regional and regional service delivery models in mid-2020.

Part B: Transition to new service arrangements – my preferred approach

87. In July 2019, I signalled that I would report back in late 2019 on three high-level options to progress improvements to three waters service delivery and funding arrangements [CAB-19-MIN-0331 refers]:
- 87.1 regulatory reform only, with voluntary, sector-led reforms to service delivery arrangements;
 - 87.2 establishment of a three waters fund to support voluntary service delivery improvements; and
 - 87.3 legislative creation of an aggregated system of dedicated, publicly-owned drinking water and wastewater providers.
88. Cabinet also agreed to support local government to consider voluntary reform. At that time, I noted that the significant costs for local government associated with investigating collaborative service delivery options, developing a business case, consulting on proposals, and establishing new entities, were likely to be barriers to pursuing reform. Recognising those challenges, Cabinet agreed to provide funding on a case-by-case basis to support and incentivise regions to investigate collaborative approaches to water service delivery [CAB-19-MIN-0331 refers].
89. Providing the sector with the time to make voluntary change to three waters service delivery is important before a legislative approach is considered. However, there is a risk that some regions will not be able to progress investigations to any formal conclusion. Even for those that do, they will still face considerable challenges to implement councils' preferred service delivery models.
90. The magnitude of change required to move from the status quo to new arrangements is significant. The benefits of allowing time to develop new service arrangements need to be balanced against the disruption that change to new models will have on local authorities, and the delivery of any existing infrastructure programmes. Identifying and, ideally, developing a consensus with the sector on a sustainable service delivery model would help to mitigate the costs of change for both the sector and the community.
91. The practical challenges of structural reform, and experiences in overseas jurisdictions, has influenced my proposed transition approach, which focuses on continuing to support local government to make voluntary changes by focusing effort in three key areas:
- 91.1 **A timeframe for local government to demonstrate adequate changes to service arrangements.** Changes to service arrangements will need to precede the regulatory milestones associated with the Water Services Bill, to enable local government and the wider sector to respond to the new regulatory regime.

91.2 Investigation of financial incentives, through a national fund, to support transition to, and implementation of, new service delivery arrangements.

While we have agreed to fund the voluntary investigation of new water service delivery arrangements on a case-by-case basis, the costs of establishing the new service providers will be a significant barrier to local government. This is likely to require further funding to support the local government sector to implement any new arrangements.

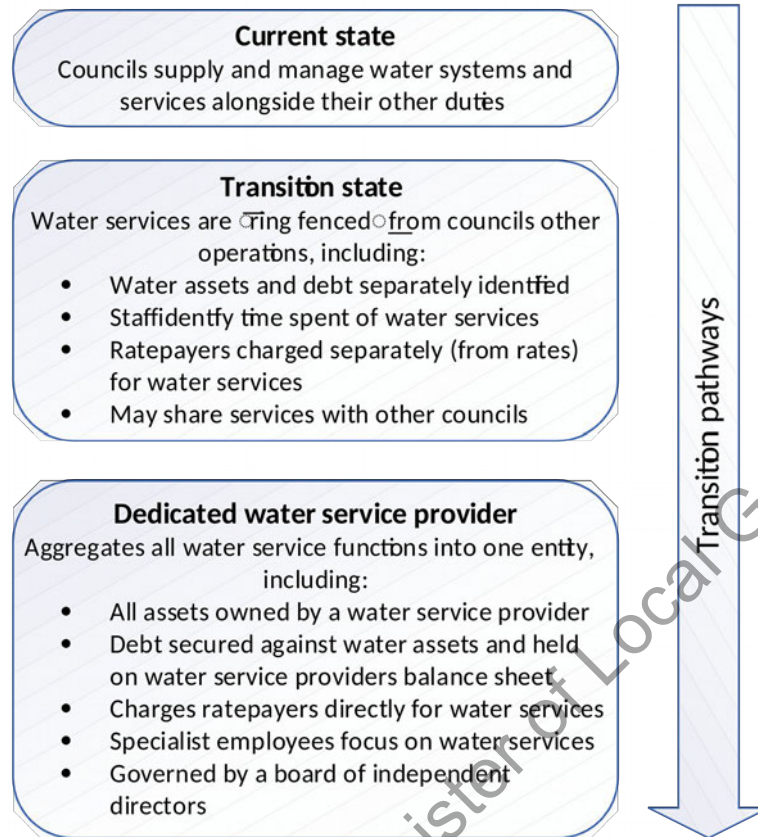
91.3 Continuing to develop advice on the legislative creation of an aggregated system of dedicated, publicly-owned drinking water and wastewater providers. Voluntary reform is difficult, and the Government will need to continue to work with the local government sector to develop a view on the appropriate arrangements for delivering water services, including any legislative requirements needed to support their implementation.

92. In the following section, I set out more detail on the key elements of this transition strategy. **Appendix 1** illustrates my approach to transition and sets out a high-level timeframe.

Continue to support local government to make voluntary changes

93. Consideration of voluntary change to three waters service delivery is important before any legislated approach is considered. We have agreed to support local government to investigate those changes, and we need to allow time for councils to undertake those investigations.
94. Almost all regions have begun to have early discussions about voluntary reform, and the Hawke's Bay and West Coast have made applications for funding to support their investigations.
95. There is also an opportunity to work with regions demonstrating leadership (like the Hawke's Bay), and existing large-scale providers (like Watercare and Wellington Water), to build consensus within the local government sector and the community to transition to more sustainable service delivery arrangements.
96. However, the experience of local government reorganisation, and previous attempts by councils in some regions to reform water service delivery, demonstrates the challenges of successfully implementing proposals to aggregate and/or share water services.
97. To be successful, we will need to partner with local government, at both a regional and national level, to support local authorities to identify and transition to new service delivery arrangements.
98. The barriers to change are both political and technical. The variability between councils' asset management approaches, and absence of reliable information on key issues like the condition of assets and the actual costs of providing services, all create challenges for councils investigating change. An example of some of the potential tasks is illustrated in the diagram below:

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99. While much of this work needs to be undertaken at a regional level, there are also opportunities to consider service delivery models at a national level. Only focusing on regions creates a risk that some councils choose new service arrangements that meet their local requirements, but fail to address wider regional issues, including the affordability challenges for small councils and their communities.
100. In partnership with local government, I am proposing that my officials continue to work with local government to develop and identify the key requirements for sustainable water service providers. This will draw on the work that has already been done in New Zealand and overseas on the different service delivery models that I have described in Part A of this paper.
101. While this work will include the development of information and guidance to councils considering change, it may also enable the Government and the sector to reach a shared view of a preferred service delivery model that could be implemented by all regions.

Set a timeframe for progress towards change to service arrangements

102. Voluntary reform is challenging. An open-ended approach to voluntary reform could mean that some regions fail to make meaningful progress on investigations, or fail to implement those changes.
103. I am proposing that we set a one-year timeframe, beginning in 2020, for local government to demonstrate meaningful progress towards change. By the end of 2020, it should be clear whether the local government sector is committed to progressing voluntary change to service delivery arrangements.

104. I believe that one year allows a reasonable time for all councils to begin work on investigating new service arrangements. It is important that they approach this task with some urgency. The new drinking water regime is expected to be implemented in 2021. I am also conscious that new service and funding arrangements enable new opportunities to address the significant number of wastewater treatment plant upgrades that are required over the next 10 years.
105. My proposed report back in mid-2020 will provide further advice on the progress that has been made by local government. However, I am not proposing a bright line test, and some judgement will need to be exercised to assess progress, but I am expecting that by the end of 2020:
- 105.1 All councils will have initiated work to investigate new service arrangements, either within regions or in partnership with other regions;
 - 105.2 at least two or three regions will have identified a preferred option and will be preparing to consult on, or will be about to implement new service arrangements.
106. My officials will work with local government to identify the opportunities to support and incentivise those regions that demonstrate leadership, including consideration of funding support for establishing the new service providers. My officials will also work with local government to explore any legislative opportunities to support and implement new service delivery arrangements more efficiently.

Investigate financial incentives, through a national fund, to support transition to, and implementation of, the new service arrangements

107. The political and economic barriers for voluntary change are high. Without financial support, it is unlikely that all regions and councils will have the financial resources and incentives needed to consider the benefits of collaboration and develop new service delivery models to meet the required objectives.
108. We have already agreed to provide funding support to local government, on a case-by-case basis, to *investigate* voluntary changes to service arrangements. Looking forward, it is likely that the costs of *implementing* any new service delivery arrangements will require further funding support. As I have noted above, the costs of establishing a service provider could be significant.

109. 9(2)(f)(iv) [Redacted]

110. 9(2)(f)(iv) [Redacted]

111. 9(2)(f)(iv) [Redacted]

112. In addition to supporting voluntary reform, there are also wider opportunities for central government to use national funding to address the current infrastructure deficits, and accelerate progress on addressing the infrastructure and operational resources needed to respond to the drinking water regulatory reforms.
113. However, further work is required to identify how any infrastructure fund would be established, what its scope would include, how it would operate, and the duration of any funding. This work will need to be developed with the Infrastructure Commission to ensure the fund will deliver what we need, where and when we need it.
114. Some initial high-level discussions with local government have identified that, while there is support for capital investment, there is a need to support ongoing operating costs. The key differences between ongoing operating and finite capital funds are summarised in the table below:

Outcomes of an ongoing operating fund versus a finite capital fund

	Ongoing operating fund	Finite capital fund
Purpose	To support water service providers' (currently councils) operating expenditure	To support specific three waters infrastructure priorities
Funding sources	Central government, local government and consumers directly based on: <ul style="list-style-type: none"> - water consumption - wastewater discharges - rateable property value 	Central government
Distribution	Based on need for investment or affordability and/or the level of voluntary aggregation	Based on an agreed infrastructure investment plan
Advantages	Means that councils that have made capital investment will still be eligible for funding	Enables a focus on specific problem areas, such as drinking water infrastructure Encourages strategic approach to major assets, such as plants that service more than one council, planning for climate

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	Ongoing operating fund	Finite capital fund
Purpose	To support water service providers' (currently councils) operating expenditure	To support specific three waters infrastructure priorities
		change etc Could use national procurement, potentially reducing cost and standardising solutions across the country
Disadvantages	The administration of the fund could be complex and costly Difficult to direct to specific problem areas or priorities, such as drinking water Could encourage continuation of current fragmented three waters service delivery	May disadvantage those that have already invested in three waters infrastructure, and reward those that have not

115. I am proposing to direct my officials to further develop an approach to a national fund, which includes consideration of the following options:

115.1 a capital fund to address the water infrastructure deficit, and how this fund could be targeted for specific outcomes;

115.2 an ongoing operating fund to support councils and/or new water service providers to deliver services.

116. My officials will work with the Infrastructure Commission to develop an approach, and a local government reference group which would include a mix of council officers and elected members will be established, to provide input into this work.

Continue to develop advice on legislative creation of an aggregated system of dedicated, publicly-owned drinking water and wastewater providers

117. Some legislative change is still likely to be required to support the voluntary creation of new water service providers. This could include amendments to existing legislation or require new legislation.

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118. As discussed in this paper, if local government is unable to make sufficient progress towards improved water service delivery across the country, the Government may need to intervene. My preference is to work in partnership with the sector as it considers voluntary change to identify what legislative changes may be required, or if there is a potential model that could be nationally implemented through legislation.
119. However, we must continue to move forward and further investigation of new models for water service provision is necessary to ensure that, should the Government be required to intervene, it can do so within a timeframe that will support the drinking water regulatory reforms. It will also ensure that that sector can respond to investment in wastewater treatment that will be required over the next decade.
120. I am proposing to direct my officials to develop a work programme to support the legislative creation of water service delivery models, should this approach be needed. This would build on the information provided in Part A of this paper, and include processes to enable input from local government.

Advice on monitoring and stewardship arrangements for the three waters system and Water Services Regulator

121. On 30 September 2019, Cabinet agreed to create a new Water Services Regulator, and made decisions about its organisational form, objectives, remit, and governance arrangements [CAB-19-MIN-0506 refers]. The Regulator will be responsible for administering and enforcing the new drinking water regulatory system, and will also undertake a small number of new, centralised functions relating to the environmental performance of wastewater and stormwater networks.
122. In that paper, I acknowledged that there would need to be further consideration about what these decisions mean for the location of policy advice, monitoring, and system stewardship functions; and Ministerial portfolio responsibilities relating to the Regulator. I undertook to prepare advice on these matters.
123. I am currently developing a proposed approach. In particular, I am considering how to address concerns about fragmentation across the three waters system, which were raised earlier in the Three Waters Review, and how to develop stewardship and monitoring arrangements that can accommodate multiple interests, roles and responsibilities. In preparing my advice, I am looking to learn from other regulatory systems that face similar issues, as well as what has worked well so far in the Three Waters Review.
124. I expect to be in a position to discuss a proposed approach with other interested Ministers, particularly the Minister of Health, Minister for the Environment, and Minister of State Services, in early 2020. I am proposing to report back in April 2020 to confirm detailed arrangements for:
 - 124.1 policy advice, monitoring, and portfolio responsibilities relating to the new Water Services Regulator; and
 - 124.2 monitoring, oversight and stewardship of the three waters system more broadly.

Consultation

125. Ministry for the Environment, Ministry of Health, Ministry of Business, Innovation and Employment; The Treasury; New Zealand Transport Agency; Ministry for Primary Industries; Ministry of Civil Defence and Emergency Management; Ministry of Housing and Urban Development; Department of the Prime Minister and Cabinet; Te Puni Kōkiri; and Te Arawhiti have been consulted on this Cabinet paper.
126. The Department of Conservation, Ministry of Education, New Zealand Defence Force, and Department of Corrections have operational responsibility for three waters services and have been consulted on this Cabinet paper in this capacity.
127. This Cabinet paper has been shared with Local Government New Zealand.

Financial implications

128. There are no direct financial implications associated with this paper, 9(2)(f)(iv)

Human rights

129. There are no human rights, gender implications or disability implications arising from the proposals in this paper.

Treaty of Waitangi

130. How the Crown engages with Māori on the Three Waters Review, and how the interests of Māori are recognised through the reforms, is not only important to ensure effective public policy decision making, but also from a Māori/Crown relationship perspective, and to ensure the Crown meets its obligations under the Treaty of Waitangi.
131. In relation to water service delivery, Māori have interests at a national, catchment and local level. As advised in the three Cabinet papers that have preceded this paper, we have worked to reflect and protect Māori interests throughout the regulatory proposals, including in the Taumata Aorowai- Water Services Regulator Bill.
132. As noted in previous advice, Māori are often disproportionately represented in rural communities that receive poor three waters services. Iwi and hapū across the country have relationships with their local authorities. In engagement to date, we have been told by Māori that the three waters arrangements are an opportunity to strengthen these relationships.

133. 9(2)(f)(iv)

134. 9(2)(f)(iv)

Legislative implications

135. There are no direct legislative implications arising from this paper. However, future papers may include proposals that may require legislative change.

Impact analysis

136. A regulatory impact analysis is not required at this stage as the proposals in this paper do not have any direct regulatory impacts.

Proactive release

137. There is widespread stakeholder interest in policy proposals for reforming the three waters. I intend to publish this paper, subject to any redactions, pursuant to Cabinet Office circular CO (18) 4.

Recommendations

138. The Minister of Local Government recommends that the Cabinet Economic Development Committee (DEV):

1. **note** that the case for change to the current structural arrangements for delivery of three waters services continues to build and that changes to how New Zealand delivers three waters services are required;
2. **note** there are key decisions that will impact on the design of service delivery arrangements, including:
 - 2.1 the scope of new water service providers;
 - 2.2 the size and scale of the new water service providers;
 - 2.3 the ownership and governance arrangements for the new water service providers;
 - 2.4 how the potential impacts of change on local government can be managed;
 - 2.5 how the performance of new water service providers will be monitored;
3. **note** there are specific objectives that are important considerations for the development of new service arrangements. These include:
 - 3.1 significantly improving the safety and quality of drinking water services, and the environmental performance of wastewater and stormwater systems;
 - 3.2 ensuring that all New Zealanders have equitable access to affordable three waters services;
 - 3.3 improving the coordination of resources and unlocking strategic opportunities to consider New Zealand's infrastructure needs at a larger scale;
 - 3.4 increasing the resilience of three waters service provision to both short and long-term risks and events, particularly climate change and natural hazards;

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- 3.5 moving the supply of three waters services to a more financially sustainable footing, and addressing the affordability and capability challenges faced by small suppliers and councils;
- 3.6 improving transparency about, and accountability for, the delivery and costs of three waters services, including the ability to benchmark the performance of service providers;
4. **note** in addition to the specific objectives for reform, there are some bottom lines that any changes to service delivery arrangements must meet. These include:
 - 4.1 protecting public investment in three waters assets;
 - 4.2 being consistent with the objectives and operating principles of Taumata Arowai—the Water Services Regulator;
 - 4.3 supporting an integrated approach to the development and management of land and water;
 - 4.4 providing a customer voice;
 - 4.5 accepting that change will have an impact on local government, but limiting the impact as much as possible;
5. **note** that there are a range of potential service delivery models, but initial analysis indicates that multi-regional and regional models perform best across all the objectives and bottom lines;
6. **agree** that the further work with local government on the design of new service arrangements will focus on multi-regional and regional models for service delivery;
7. **agree** that we should continue to support local government to make voluntary changes to service delivery arrangements;
8. **note** that local government must make progress on voluntary sector-led reforms to service delivery arrangements to ensure the local government sector can respond to our drinking water regulatory reform programme;
9. **agree** to set a one-year deadline, beginning in 2020, by which the local government sector needs to demonstrate that it has made progress with voluntary reform;
10. **note** that I will provide further advice on how local government progress will be assessed and determined, but I am expecting by the end of 2020 that:
 - 10.1 most councils will have initiated work to investigate new service arrangements, either within regions or in partnership with other regions;
 - 10.2 at least two or three regions will have identified a preferred option, and will be preparing to consult on, or implement new service arrangements;
11. **note** that Cabinet has agreed that proposals for support from regions on voluntary changes to water service delivery arrangements should be considered on a case by case basis [CAB-19-MIN-0331 refers];

12. 9(2)(f)(iv) [REDACTED]
13. **note** that a three waters infrastructure fund could provide an opportunity to support local authorities to address the three waters infrastructure deficit, accelerate progress on improving drinking water, and support improvements to environmental outcomes;
14. **invite** the Minister of Local Government to provide an oral update to DEV, in April 2020, on initial progress with the voluntary, local government sector-led reforms to service delivery arrangements
15. **invite** the Minister of Local Government to report back to DEV, in mid-2020, with:
- 15.1 a report on progress with the voluntary, local government sector-led reforms to service delivery arrangements, and any other actions that may be needed to support voluntary reform;
 - 15.2 advice on a possible national three waters infrastructure fund;
 - 15.3 advice on a work programme to support further analysis of aggregated multi-regional and regional service delivery models, should this approach be needed;
 - 15.4 advice on whether further work on a dedicated economic regulation regime is warranted in light of progress made on voluntary, local government led reforms to service delivery arrangements;
16. **note** that local authorities are already required by the Local Government Act 2002 to report on financial and non-financial performance, including measures relating to three waters services, and there is potential to make better use of these mechanisms;
17. **direct** the Department of Internal Affairs, in consultation with the Ministry of Business, Innovation and Employment, to explore whether the existing three waters performance measures referred to in recommendation 16 can be revised to provide better information on the quality of three waters services being delivered to New Zealanders;
18. **note** that it is intended that the work referred to in recommendations 15 and 17 will be undertaken in partnership with local government, and a local government reference group will be convened to develop the advice on these matters;

Advice on monitoring and stewardship arrangements for the three waters system and Water Services Regulator

19. **note** that when decisions were made about the organisational form and remit of a new Water Services Regulator, on 30 September 2019, it was acknowledged that there would need to be further consideration about what these decisions mean for the location of policy advice, monitoring, and system stewardship functions, as well as Ministerial portfolio responsibilities [CAB-19-MIN-0506 refers];

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20. **note** that the Minister of Local Government is developing a proposed approach to the matters referred to in recommendation 19, for discussion with the Minister of Health, Minister for the Environment, and Minister of State Services in early 2020;
21. **invite** the Minister of Local Government to report back in April 2020 to confirm arrangements for:
 - 21.1 policy advice, monitoring, and portfolio responsibilities relating to the new Water Services Regulator;
 - 21.2 monitoring, oversight and stewardship of the three waters system more broadly.

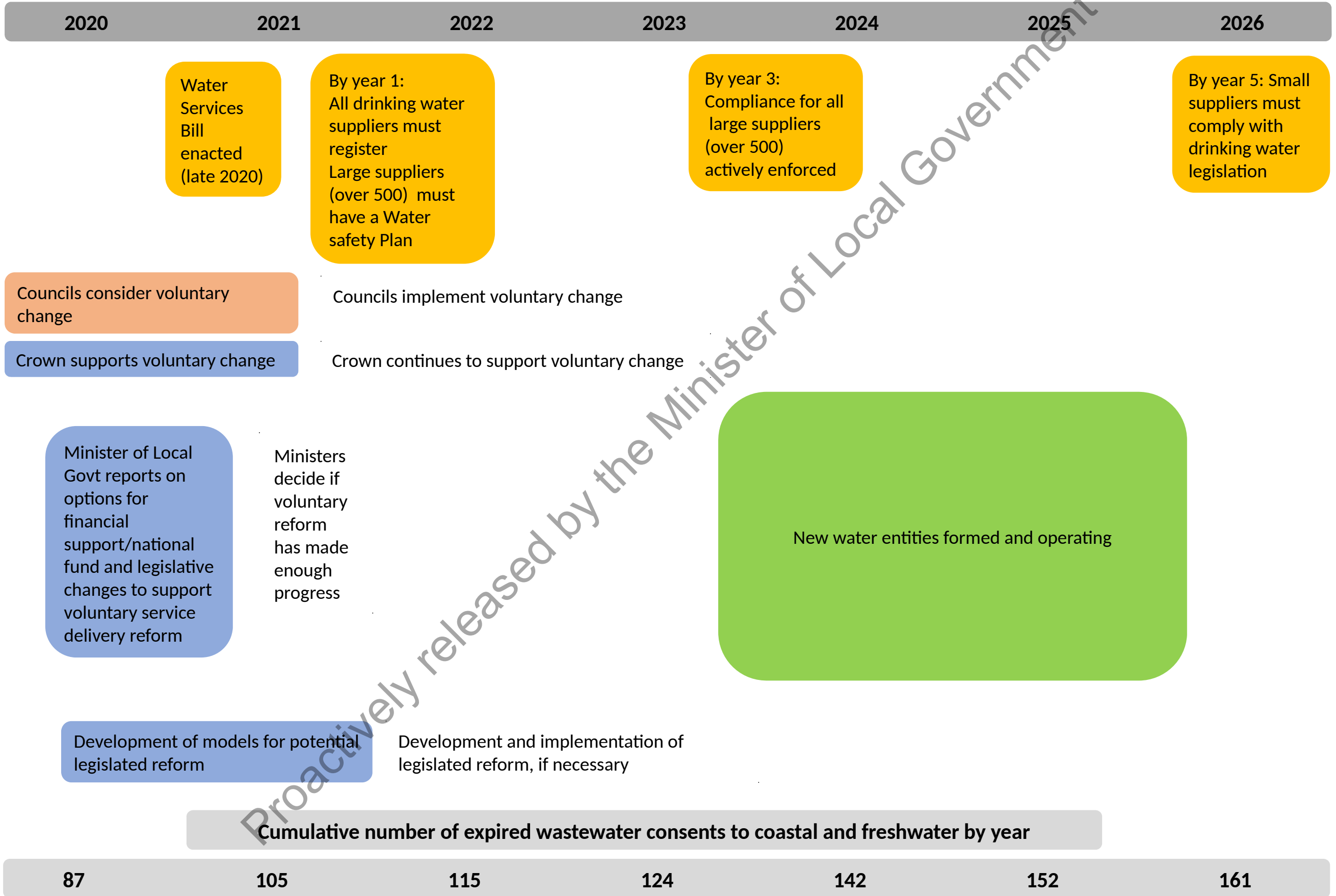
Authorised for lodgement

Hon Nanaia Mahuta

Minister of Local Government

Proactively released by the Minister of Local Government

Transition plan for three water service delivery arrangements



Proactively released by the Minister of Local Government