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Hon Nanaia Mahuta, Minister of Local Government

Proactive release of Cabinet material about the plan for three waters reform
1 July 2019

The following documents have been proactively released:

1 July 2019, CAB-19-MIN-0331 Minute: A Plan for Three Waters Reform, Cabinet Office; and

1 July 2019, Cabinet Paper: A Plan for Three Waters 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)(ba)(i) – protect information which is subject to an obligation of confidence

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Cabinet

Minute of Decision

This document contains information for the New Zealand Cabinet. It must be treated in confidence and handled in accordance with any security classification, or other endorsement. The information can only be released, including under the Official Information Act 1982, by persons with the appropriate authority.

A Plan for Three Waters Reform

Portfolio **Local Government**

On 1 July 2019, following reference from the Cabinet Economic Development Committee, Cabinet:

- 1 **noted** that on 5 November 2018, Cabinet agreed that the government embark on a process of three waters reform over the next 18 months, seeking detailed policy decisions in tranches in 2019, with a view to introducing legislation in 2020 [CAB-18-MIN-0545];
- 2 **noted** that the first part of delivering the strategy for three waters reform is regulatory reform, and that agreement to a package of policy proposals is being sought in the accompanying paper, *Strengthening the Regulation of Drinking Water, Wastewater and Stormwater* [CAB-19-MIN-0332];
- 3 **noted** that some smaller communities are not well-positioned to respond to the proposed reforms and to deliver quality three waters infrastructure and services, and that there will be a need to address the funding challenges that are facing these communities;
- 4 **noted** that some regions are investigating options for making voluntary changes to local water service delivery and funding arrangements, but would benefit from help to progress this work, through financial assistance and the removal of barriers created by legislation;
- 5 **agreed** that proposals for support for regions on voluntary changes to water service delivery arrangements be considered on a case by case basis;
- 6 **authorised** a group of Ministers comprising the Minister of Finance, Minister of Local Government and the Minister of Internal Affairs to have Power to Act to take decisions on:
 - 6.1 proposals from regions for funding to support and incentivise regions in their investigation of collaborative water service delivery changes;
 - 6.2 changes to appropriations to meet the costs involved with any proposals approved under paragraph 6.1 above;
- 7 **noted** that there are links and overlaps between the Three Waters Review and the Essential Freshwater programme, and that these programmes need to continue to be closely aligned;

- 8 **noted** that the more that the three waters proposals are designed to uphold Te Mana o te Wai and to reflect Māori interests, the better positioned Māori and the Crown will be when it comes to discussing Māori rights and interests in the Essential Freshwater programme;

Michael Webster
Secretary of the Cabinet

Hard-copy distribution:

Prime Minister
Deputy Prime Minister
Minister of Finance
Minister of Local Government
Minister of Internal Affairs

Proactively released by the Minister of Local Government

Office of the Minister of Local Government

Chair

Cabinet Economic Development Committee

A plan for three waters reform

Proposal

1. This is the first in a series of papers on the Three Waters Review to be considered during 2019. It provides an overview of my plan for three waters reform and explains the connections with the Essential Freshwater programme. It also seeks approval for additional operating funding to support and incentivise councils to progress with voluntary changes to service delivery arrangements.
2. This paper sets the scene for, and is intended to be read in association with, the Cabinet paper *Strengthening the regulation of drinking water, wastewater and stormwater*.

Executive summary

3. In late 2017 and 2018, we considered a series of papers relating to the system for regulating and managing drinking water, wastewater and stormwater (the three waters). These papers highlighted that, in many parts of the country, communities cannot be confident that drinking water is safe, or that good environmental outcomes are being achieved. They also raised concerns about the regulation, sustainability, capacity and capability of a system with a large number of localised providers, many of which are funded by relatively small populations.
4. In November 2018, Cabinet agreed that the Government would embark on a process of three waters reform, seeking detailed policy decisions in tranches in 2019. In April 2019, it was agreed that the Three Waters Review is a Government priority.
5. I am leading this work, and will be presenting the following suite of papers over the coming months:
 - 5.1 *A plan for three waters reform* (this paper).
 - 5.2 *Strengthening the regulation of drinking water, wastewater and stormwater* – to be considered following this paper (prepared with the Minister of Health and the Minister for the Environment).
 - 5.3 *Institutional arrangements for a regulator* – August 2019.
 - 5.4 *Three waters service delivery and funding arrangements* – late 2019.
6. In this paper, I outline the strategy for three waters reform, starting with delivering on our priority to strengthen the regulation of drinking water, wastewater and stormwater. The accompanying paper seeks agreement to a package of policy proposals to achieve this priority. Together, these proposals would address the shortcomings with the current regulatory system, provide greater confidence in the safety of our drinking water, and ensure good environmental outcomes are being achieved.

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7. It is important that we proceed with these regulatory reform proposals. While this may be challenging for some service providers, the overall cost-benefit through improved delivery models will be an advantage. This is also an opportunity to address affordability challenges and the significant disparities between communities, in terms of the safety, reliability and price of their drinking water, and the environmental outcomes they experience. We need to ensure that some communities do not continue to fall behind the rest of the country.
8. The regulatory reforms will be phased in, providing us with time to consider how to deal with these issues, and for service providers to adjust. Moreover, the reforms are part of a broader, longer-term strategy to improve the three waters system. As part of this work, I will be considering options for improving service delivery and funding arrangements later this year.
9. There are opportunities for local authorities to make voluntary changes to their service delivery and funding arrangements. Some regions, including Waikato and Hawke's Bay, are already exploring local options and solutions, but face significant obstacles in progressing and implementing change. These regions would benefit from help to progress this work, through financial assistance and the removal of legislative barriers to change. Government has a role to encourage and incentivise a voluntary shift in service delivery arrangements.
10. The Department of Internal Affairs has reviewed options for reprioritising funding from within Vote Internal Affairs baselines of the fiscal forecast period. I am advised that, although Budget 2019 initiatives have provided some relief for departmental cost pressures, significant cost pressures remain an issue for the Department to manage over the forecast period. These cost pressures have been largely driven by increased demand for Crown-funded services, and the required investment to meet service delivery expectations. As such, I am advised that the costs to undertake my proposed programme of work cannot be met within the Department's existing baselines.
11. I am therefore seeking the approval for a \$5 million increase to the Vote Internal Affairs appropriations to support regions in their investigations of voluntary service delivery improvements, incentivise other regions to follow suit, and to enable my officials to investigate legislative barriers to voluntary change. Consideration of voluntary change is an important first step. It will help to inform my advice to Cabinet later in 2019 on whether statutory reforms might be required to achieve lasting solutions to the financial and capability challenges facing the three waters.
12. There are also opportunities for the three waters work to help us to deliver the outcomes being sought in Essential Freshwater. There are links and overlaps between these programmes, in particular Te Mana o te Wai, which is a holistic approach to the utilisation and management of water.¹

¹ Te Mana o te Wai is defined in the National Policy Statement for Freshwater Management as the integrated and holistic wellbeing of a freshwater body (page 7). This definition is also applied throughout this paper.

Background

During 2017 and 2018, we heard about significant issues facing the three waters system, and were presented with a compelling case for change

13. In late 2017 and 2018, we considered a series of papers relating to the system for regulating and supplying drinking water, wastewater and stormwater. These papers presented the initial findings from the cross-agency Three Waters Review, and issues and recommendations from the Government Inquiry into Havelock North Drinking Water (Havelock North Inquiry).
14. The papers highlighted that, in many parts of the country, communities cannot be confident that their drinking water is safe, or that good environmental outcomes are being achieved from wastewater and stormwater systems. They also raised concerns about the regulation, sustainability, capacity and capability of a system with a large number of localised providers, many of which are funded by relatively small populations.
15. The Havelock North Inquiry concluded that the problems in Havelock North are not confined to that area, and there is a widespread systemic failure of water suppliers to meet the high standards required to ensure the safe supply of drinking water to the public. If action is not taken, there are risks of similar incidents occurring elsewhere, with potentially serious consequences.
16. We also noted that there will be broader national and local implications if performance improvements are not delivered across the three waters system, including:
 - 16.1 housing infrastructure supply being unable to meet demand in high-growth areas;
 - 16.2 failure to meet national and local environmental objectives for freshwater and the marine environment;
 - 16.3 a constrained ability to plan and fund robust systems that can cope with climate change, emergencies, and natural hazards;
 - 16.4 limitations on developing the regions, particularly for areas with declining rating bases, or small tourism centres with high seasonal demand.
17. The events that led to the Havelock North contamination event, along with the findings of the subsequent Inquiry, have demonstrated that the existing system does not adequately safeguard against the risk of catastrophic contamination incidents, or drive improved compliance with the drinking water standards.
18. The Inquiry also observed there is little understanding among the New Zealand public about the large numbers of people who consume unsafe drinking water. Every year, around 34,000 people become ill from their drinking water, and many more must boil their water to drink it safely.
19. Council wastewater systems are facing similar widespread challenges. Wastewater plants are affecting freshwater and coastal water quality, and sewage overflows are occurring at a frequency that is no longer acceptable for communities, including Māori. A high number of wastewater treatment plants are legally operating on expired consents for long periods of time. In many regions, regional councils do not (and are not required to) publish sufficient information to provide assurance about the impact of wastewater services on the environment.

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20. The papers noted that hard data on the extent of the problem is variable and, in some cases, limited, which is in itself evidence of a wider systemic issue. However, overall, the following problems affect all of the three waters:
 - 20.1 *Weaknesses across the regulatory system.* Both drinking water and environmental regulation exhibit, in differing degrees, inadequate stewardship, leadership, and compliance, monitoring and enforcement practices. Specific issues are explained throughout the accompanying paper, *Strengthening the regulation of drinking water, wastewater and stormwater.*
 - 20.2 *Funding and financing challenges.* Three waters providers face a range of affordability issues and financial pressures. Many councils are struggling to fund plant and pipe infrastructure to the level required to meet standards and community aspirations, keep pace with population growth, and build resilience against natural events. Affordability challenges are particularly acute for smaller communities, rural and provincial councils, non-council drinking water suppliers, and marae. These communities are finding it difficult to afford quality infrastructure and services, especially within current structures and funding arrangements.
 - 20.3 *Capability and capacity challenges.* Good capability is the key to meeting regulatory requirements, designing, procuring, delivering and managing three waters services, and undertaking complex public health and environmental risk assessments. However, it is often difficult for 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).

In November 2018, we agreed to a road map for future decisions on three waters reforms – decisions that will be made over the coming months

21. In November 2018, Cabinet agreed that the Government would embark on a process of three waters reform over the next 18 months, seeking detailed policy decisions in tranches in 2019 [CAB-18-MIN-0545 refers].
22. Firstly, Cabinet invited me, the Minister of Health, and the Minister for the Environment to report back to the Cabinet Economic Development Committee (DEV), in June 2019, with a package of regulatory proposals. These proposals would enable drafting of legislation to commence in the following areas:
 - 22.1 system-wide reform of drinking water regulation;
 - 22.2 a new risk management regime for sources of drinking water;
 - 22.3 targeted reform of environmental regulation of wastewater;
 - 22.4 measures to give greater transparency around the operation of wastewater and stormwater systems, and to promote better practice;
 - 22.5 the institutional arrangements, and oversight and stewardship needed to give effect to these reforms.
23. Secondly, I was invited to report back to DEV, in late 2019, on proposals for service delivery arrangements, following analysis of three high-level options:

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- 23.1 regulatory reforms only, with voluntary, sector-led reforms to service delivery arrangements;
 - 23.2 a three waters fund to support voluntary service delivery improvements;
 - 23.3 an aggregated system of dedicated, publicly-owned, drinking water and wastewater providers.
24. Cabinet also invited me and the Minister of Commerce and Consumer Affairs to report back to DEV, in late 2019, with proposals for the economic regulation of three waters services, if appropriate.
25. During the rest of this year, I will be preparing a suite of papers to report back on these matters. This paper is designed to set the scene and strategic context for three subsequent papers:
- 25.1 *Strengthening the regulation of drinking water, wastewater and stormwater* (June 2019 – following consideration of this paper).
 - 25.2 *Institutional arrangements for a regulator* (August 2019).
 - 25.3 *Three waters service delivery and funding arrangements* (late 2019).
26. This paper also considers the bigger picture and explains how three waters reforms are an important component of the Government's broader approach to water reform.

These decisions are aligned with the Essential Freshwater programme

27. This Government launched its Essential Freshwater programme in 2018. The Essential Freshwater Cabinet paper (to be considered by DEV in August 2019) responds to the Government's direction to halt further degradation and loss, reverse past damage, and create a fair system for allocating nutrient discharges.
28. The Three Waters Review and Essential Freshwater programme are proceeding in tandem, but on different timeframes due to the urgent need to fix issues with the current drinking water regulatory system (as demonstrated by the Havelock North incident and described by the Inquiry).
29. The relationship between the Three Waters Review and Essential Freshwater programme provides an opportunity to support the discussion with Māori about rights and interests in freshwater, to contribute to Te Mana o te Wai, and to enhance the Māori-Crown relationship. We are realising this opportunity by recognising and enhancing Māori interests in the reform proposals. This is discussed later in this paper.

Comment

Three waters reform: my strategy for 2019 and beyond

Our first priority is strengthening the regulation of drinking water, wastewater and stormwater

30. The accompanying paper seeks agreement to a package of proposals to strengthen the regulatory arrangements for the three waters system. Together, these proposals provide greater confidence that our drinking water is safe, and protect and enhance our environment.

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31. At the heart of the reforms are proposals that all drinking water suppliers (except individual domestic self-suppliers) would be covered by the regulatory system and required to provide safe drinking water on a consistent basis. This approach recognises that access to safe and reliable drinking water is essential to life, to the health, wellbeing and resilience of our communities, and to a high-performing economy.
32. Other core proposals include:
 - 32.1 A central regulator to carry out new and enhanced functions across the drinking water regulatory system, and an opportunity for that regulator to undertake some wastewater and stormwater functions as well.
 - 32.2 Stronger requirements to manage risks to drinking water safety, including doing more to protect drinking water sources, taking a multi-barrier approach to drinking water safety, and improvements to water safety planning.
 - 32.3 A stronger, centralised approach to drinking water compliance, monitoring and enforcement, with the regulator having the ability to support suppliers to comply with their regulatory obligations, and to act to address non-compliance.
 - 32.4 Lifting the performance of wastewater and stormwater systems, through new national environmental standards for wastewater discharges and overflows, and new obligations on network operators to manage risks to people, property and the environment associated with the operation of their networks.
 - 32.5 Providing greater transparency about wastewater and stormwater networks, by requiring operators to report annually on a set of nationally-prescribed environmental performance metrics, including the status of active and expired discharge consents, and the anticipated timeframes for renewals.
 - 32.6 Improving national-level leadership, oversight and support relating to wastewater and stormwater regulation, including national guidance for local authorities regarding the compliance, monitoring and enforcement approaches to be used for wastewater and stormwater network operators.

It is important that we proceed with these reforms, even though this may be challenging for some service providers

33. Strengthening the three waters regulatory system places greater emphasis on compliance with legislation and standards, as well as introducing some additional requirements for service providers. This will drive expenditure and investment decisions.
34. I am aware of concerns about the potential costs and challenges associated with complying with regulatory requirements and implementing the proposals. This was a common theme during stakeholder engagement, which was raised by local government, iwi/Māori, and Crown agencies that provide three waters services. Local authorities also asked about the longer-term implications of the proposed reforms, and what this might mean for the way local services are delivered and paid for in future.

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35. While these concerns are understandable and require further consideration, it is important that we proceed with the regulatory reform proposals. This is an opportunity to address the significant disparities between communities, in terms of the safety, reliability and price of their drinking water, and the environmental outcomes they experience. We need to ensure that our poorer communities do not continue to fall further and further behind the rest of the country.
36. Māori are particularly over-represented in communities that receive poor quality or no three waters services. An example is Te Kao, a predominantly Māori community in Northland of approximately 60 households. Te Kao has been on a boil water notice since 2003, shortly after the water supply owned and operated by the Far North District Council was privatised. The options canvassed to try and resolve the situation have been too expensive for this low-income community. In the meantime, I have heard anecdotally that many of the community cannot afford the expense of continually boiling or buying water, so instead run the risk of drinking untreated water.
37. It is also important to remember that, when the current drinking water regulatory system was introduced, concessions were made that limited its scope and effectiveness. This has meant that some suppliers are not regulated effectively, and others are not regulated at all.
38. The proposals in the accompanying paper address these failings, by bringing all suppliers into the regulatory system, building capability, and requiring the regulator to take a stronger approach to non-compliance. While it may be difficult for some suppliers to comply at first, experience in New Zealand and overseas has shown that we should be firm in our resolve to pursue these reforms, and that good quality water services are affordable as a country if we get the settings right.

The regulatory reforms will be phased in, providing time for us to consider how to address these issues, and for service providers to adjust

39. We will have time to consider how best to address these issues. Most of the proposals require legislation to implement or would be given effect through regulations under the Resource Management Act 1991 (RMA). It will take time to develop, consider and pass legislation, and to design and implement the new regulations.
40. In addition, three waters service providers will not be expected to comply with the proposed new regulatory system without support, and without time to adjust.
41. The accompanying paper, *Strengthening the regulation of drinking water, wastewater and stormwater*, outlines the timeframes for implementing and complying with the new drinking water regulatory system. The proposed approach recognises that it will take time to fully implement the new system, and smaller suppliers are likely to require longer to comply with their obligations.
42. The paper also proposes that a significant part of a central regulator's role would be to build capability and capacity across the three waters sector. This would involve supporting drinking water suppliers to comply with their regulatory obligations, focusing particularly on smaller suppliers. Support functions relating to wastewater and stormwater are also proposed, such as identifying and promoting good practices.
43. I am proposing to seek further decisions on the institutional arrangements for a central regulator in August 2019, including the form and location of the regulator.

The regulatory reforms are also part of a broader, longer-term strategy to improve the three waters system

44. Later this year, I will be reporting back on options to improve three waters service delivery and funding arrangements. Three high-level options are being explored (with the potential for some variations within these options):
 - 44.1 proceed with regulatory reforms only, with voluntary, sector-led reforms to service delivery arrangements;
 - 44.2 establish a three waters fund to subsidise infrastructure costs for struggling communities;
 - 44.3 develop options for a system of larger, publicly-owned, drinking water and wastewater providers.
45. I anticipate providing an update on progress with developing these options, and potentially seeking agreement to pursue particular options, rather than making significant reform decisions this year.
46. The paper will also provide further advice on the cost implications associated with the regulatory reform proposals and consider how we might address these implications.
47. Several pieces of research have been commissioned to help us to understand the potential costs associated with drinking water reforms, including:
 - 47.1 a national cost estimate of upgrading networked (council and non-council) water treatment plants to meet drinking water standards;
 - 47.2 supplementary research to identify potential costs for specified self-suppliers.
48. Nationally, the estimated capital costs of upgrading networked drinking water treatment plants to meet drinking water standards is between \$309 million and \$574 million, and an additional annual operating cost of \$11 million to \$21 million.² These costs, if spread across the New Zealand population, would be around \$36 per household, per year. This does not include the cost for upgrading the water treatment plants of specified self-suppliers, such as schools, prisons and campgrounds, or very small supplies.
49. Research is also being undertaken into the potential costs of upgrading wastewater treatment systems, if national standards were imposed. This involves identifying national cost estimates relating to:
 - 49.1 upgrading wastewater treatment plants discharging to freshwater to meet objectives (Attribute B) of the National Policy Statement (NPS) for Freshwater Management;
 - 49.2 the upgrades required to meet a minimum standards regime for coastal wastewater treatment plants;
 - 49.3 the upgrades required to reduce wastewater overflows to two per year.

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

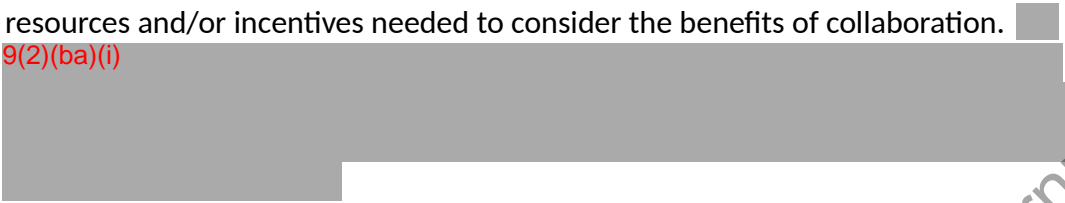
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50. Some of this research is still being finalised, but indicative cost estimates are that the cost of upgrading non-compliant wastewater treatment systems over the coming years falls within a range of \$3.0 billion to \$4.3 billion, with an additional annual operating cost of \$126 million to \$193 million. If spread across the New Zealand population, the capital cost per person would be around \$961, and the annual operating cost per household around \$117. A large part of these costs will need to be incurred under existing regulation and should already be part of councils' long-term plans.
51. It appears that the costs are absorbable in many parts of the country, particularly in our bigger cities and growth areas, where costs can be shared across many people. Many councils are already planning significant investments in three waters infrastructure. Across the sector, councils are planning to spend nearly \$4 billion on improving and replacing drinking water infrastructure assets, and nearly \$5 billion on wastewater infrastructure, over the next 10 years.
52. The challenge we face, though, is that some of our smaller councils and communities, and many non-council drinking water suppliers (including marae) are not well-positioned to respond to the proposed reforms. As noted earlier, many communities (including places visited by high numbers of tourists) are already struggling to pay for three waters infrastructure and services. Drinking water suppliers that are being brought into the regulatory system for the first time may face similar difficulties.
53. There are also gaps in the research, which mean there are likely to be additional costs. There is a lack of information on the condition of council drinking water, wastewater and stormwater pipes, and how much investment is needed to repair or replace ageing infrastructure.
54. We need to consider how to ensure all communities can experience the benefits of the reform proposals, and receive safe, reliable, culturally-acceptable three waters services, in an affordable way. This may include thinking differently about how these services are paid for. I am exploring options for sharing costs across communities, or a nationwide fund, and will provide further advice on these matters at the end of this year.

There are opportunities for local government to make voluntary changes to service delivery and funding arrangements, and we can support them to do this

55. One of the options being explored involves proceeding with regulatory reforms and enabling local authorities to make any changes that may be needed to their service delivery arrangements. This includes local decisions to change how three waters services are structured and funded within or across districts and regions.
56. Some local authorities have already responded positively to this approach and are collaborating on options and solutions for improving water service delivery arrangements across their regions. These approaches range from entering into contracts with other service providers (such as South Wairarapa District Council joining Wellington Water, and Watercare providing services for Waikato District Council), to considering regionalising drinking water and wastewater services (such as Hawke's Bay councils and a sub-regional group of Waikato councils).

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57. There are, however, significant costs for local government associated with investigating collaborative service delivery options, developing a business case, consulting on proposals, and establishing new entities. These costs are likely to be a barrier to pursuing reform – particularly for councils with limited resources and smaller ratepayer bases, which are likely to benefit most from shared water services.
58. Without financial support, it is unlikely many interested councils will have the financial resources and/or incentives needed to consider the benefits of collaboration.  9(2)(ba)(i)
59. Current legislation may also make it difficult for some of the collaborative initiatives to proceed and adds cost to the process. For example, the formation of a regional or sub-regional water asset-owning council-controlled organisation is very challenging under existing legislation. I have directed my officials to investigate what is involved in addressing the barriers to voluntary reform that regions have highlighted in their discussions. I am proposing that options to address these issues would be included in my paper at the end of this year.
60. I am seeking agreement to funding of \$5 million for 2019/20 to support and incentivise regions to investigate large-scale, collaborative approaches to water service delivery.
61. The fund, which would be approved for draw down by myself and the Minister of Finance, would provide up to \$1 million (each) to assist four to six regional initiatives. It is intended as a co-investment with local government to assist with business case development, due diligence, and community consultation in regions or sub-regions considering voluntary change.
62. The fund would provide an incentive for those regions to be the ‘first movers’ and proceed to community consultation on new water service delivery arrangements. I am hopeful that, by demonstrating the feasibility and benefits of new approaches, this encourages local authorities in other regions to also start exploring options for change.
63. If new water service organisations are established through the consultation process, this would place these councils and regions in a stronger position to respond to the financial and capability challenges facing the three waters system. It would also help them to respond to any regulatory and service delivery reforms that are developed.
64. I propose that the Department of Internal Affairs (the Department) manages the process for receiving and approving applications to this fund, with expressions of interest opening in July 2019. A portion of the additional \$5 million of funding would also cover the Department’s staffing, administrative and travel costs associated with this process.
65. Applications would need to meet certain conditions; for example, they would need to be made on behalf of a group of councils working collaboratively, and meet any timeframe set by the Department. A 50/50 split with central government on the cost of business cases would also be expected, with any cost overruns being the responsibility of councils. Officials would work closely with councils/regions as they develop and implement their proposals, and ensure the fund is being spent according to the conditions.

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66. If regions achieve public and political support to establish a new water entity, I will consider what further central government support (financial or otherwise) might be necessary in the establishment phase.
67. Whether or not changes are made voluntarily may ultimately come down to local resolve and democratic decision making. The results of this funding process would help central government to understand the feasibility of achieving nationwide service delivery reforms voluntarily; what kind of approaches, motivations, and incentives are effective; and if/how to support reform proposals in other parts of the country in future.
68. The Government will also need to consider how to proceed if insufficient progress is made across the country. The funding process would inform my advice to Cabinet later in the year on whether statutory reforms might be required to achieve lasting solutions to the financial and capability challenges facing the three waters.
69. The Rates Rebate Scheme has had historical underspends ranging from \$5.960 million to \$9.324 million. I anticipate a predicted underspend in the 2019/20 Rates Rebate Scheme will be sufficient to cover the proposed \$5 million fund.

Relationship between the Three Waters Review and Essential Freshwater work programme

There are opportunities for the three waters work to support the Essential Freshwater programme and strengthen Te Mana o te Wai

70. The Essential Freshwater programme is focused on establishing an integrated freshwater system that ensures all discharges and water users are contributing to, and protecting and restoring, ecosystem health and water quality. It is focused on fundamental issues regarding the allocation and management of freshwater, including how best to manage discharges at a macro or catchment level (agricultural as well as urban).
71. The Government's priority, in this term, is stopping further degradation to, and starting to restore, water quality. It has also agreed to take a phased approach to policy development and engagement with Māori across all freshwater issues, starting with a focus on water quality.
72. The Three Waters Review is more narrowly focused than the Essential Freshwater programme. It is a targeted initiative to address immediate concerns about drinking water safety, and the performance of wastewater and stormwater systems.
73. There are links and overlaps between the two programmes, including in respect of Māori rights and interests, and Te Mana o te Wai. The programmes need to continue to be closely aligned if we are to make progress on addressing Māori rights and interests in water, and if we are to uphold Te Mana o te Wai.
74. Several governance and project management arrangements are in place to support alignment between the two programmes, including regular Ministers' meetings and fortnightly meetings between agency water directors. Kahui Wai Māori (the Māori Freshwater Forum established to advise on the Essential Freshwater programme) has also been providing advice on the Three Waters Review.

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75. I am mindful that any system architecture developed for the three waters (including the central regulator) will need to fit with, or be able to be adjusted to fit with, the system architecture developed through the Essential Freshwater programme and RMA reforms.
76. One of the stated principles of the Essential Freshwater programme is addressing rights and interests of Māori in freshwater.³ The Crown has acknowledged these rights and interests exist, and this Government has confirmed they need to be addressed if issues such as water allocation are to be progressed.⁴
77. The rights and interests discussion has its challenges, not least because of historical inequities in the way water has been allocated, and differing views about “ownership” or customary interests in water. Furthermore, this Government does not have a mandate within this term to address issues such as user charging and royalties, which affects how far we can progress discussions about Māori rights and interests.
78. In my discussions with Māori about the three waters, I have been careful to emphasise that the primary place for the “rights and interests” discussion about water is within the Essential Freshwater programme.
79. There are natural resource rights and interests that have been established in Treaty settlement agreements that will need to be considered in the creation of a regulator. For the avoidance of doubt, the creation of a regulator will not amend existing Treaty settlement arrangements.
80. Moreover, Māori interests are more clearly articulated in a whole of system approach that does not delineate freshwater, three waters, marine or urban water, as determined by government policy objectives. This whole of system approach is reflected in Te Mana o te Wai, and how mātauranga Māori is integrated into a regulatory framework to enable the practice of kaitiakitanga.

Te Mana o te Wai is the key to an integrated, holistic water management system

81. When Te Mana o te Wai is recognised and provided for, the water body will sustain the full range of environmental, social, cultural and economic values held by the iwi, hapū, whānau and the community. One of the overriding concerns expressed by Māori during engagement on the Three Waters Review has been that proposals for reform need to uphold Te Mana o te Wai.
82. Te Mana o te Wai is incorporated in our water management system through the National Policy Statement (NPS) for Freshwater Management. This NPS provides direction on how local authorities should carry out their responsibilities under the RMA for managing freshwater.
83. The NPS for Freshwater Management currently requires local authorities to consider and recognise “Te Mana o te Wai” in freshwater management. In this context, it is intended to accommodate sufficient flexibility to enable “each community to decide what Te Mana o te Wai means to them at a freshwater management unit scale, based on their unique relationship with freshwater in their area or rohe”.

³ See Ministry for the Environment and Crown Relations Unit; *Essential Freshwater: Healthy Water, Fairly Allocated*; page 20.

⁴ See Ministry for the Environment and Māori Crown Relations Unit; *Shared Interests in Freshwater: A New Approach to the Crown/Māori Relationship for Freshwater* (2018).

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84. The NPS for Freshwater Management states that in “upholding Te Mana o te Wai, these discussions should explore all values the community holds for freshwater; however, the health and wellbeing of freshwater should come first”. Prioritising the health and wellbeing of the water has not always been reflected in the actual decisions made about water management.
85. The NPS for Freshwater Management is one of the key mechanisms for achieving an integrated freshwater system. Work is being undertaken through the Essential Freshwater programme to strengthen the NPS for Freshwater Management by giving stronger recognition to Te Mana o te Wai, and providing greater clarity around how to recognise and provide for it.
86. We are also working to ensure that the three waters proposals contribute to upholding Te Mana o te Wai, by strengthening how Te Mana o te Wai is reflected throughout the three waters system, and by aligning Essential Freshwater and the Three Waters Review so that together they contribute to a holistic and integrated whole of system approach to water management. Examples include:
- 86.1 requiring all drinking water suppliers to provide demonstrably safe drinking water;
 - 86.2 requiring local authorities to ensure all communities have access to safe drinking water;
 - 86.3 ensuring source waters are adequately protected to support the provision of safe drinking water;
 - 86.4 ensuring wastewater and stormwater proposals can support the cultural and community values and objectives expressed in national/regional policy statements and regional plans;
 - 86.5 providing opportunities to incorporate mātauranga Māori and the involvement of tangata whenua in the monitoring of environmental outcomes where relevant.
87. Further opportunities lie in the service delivery part of the three waters programme. Iwi who have settled their Treaty claims have negotiated co-governance and co-management arrangements, usually catchment-based and with local government. In general, these arrangements have enabled increased iwi participation in local authority decision making over natural resources; helped to build iwi (and local authority) capacity, capabilities and expertise; and strengthened relationships. Settled iwi are increasingly positioning themselves to lead discussions on regional development, including discussions about infrastructure.
88. My approach has been, and will continue to be, that the more we can do to uphold Te Mana o te Wai and to reflect Māori interests in the three waters proposals, the better positioned both Māori and the Crown will be when it comes to discussing Māori rights and interests in the Essential Freshwater programme. This will enhance the Māori-Crown relationship.

Consultation

89. The Ministry of Business, Innovation and Employment, the Treasury, the New Zealand Transport Agency, the Ministry for Primary Industries, the Ministry of Civil Defence and Emergency Management, the Ministry of Housing and Urban Development, the Department of the Prime Minister and Cabinet, Te Puni Kōkiri, Te Arawhiti, the Department of Conservation, Ministry of Education, New Zealand Defence Force, and Department of Corrections have been consulted on this Cabinet paper.
90. The Treasury does not support the provision of funding to support investigations of voluntary changes to water delivery and funding arrangements, and provided the following comments: "This proposal is substantially similar to an initiative submitted and declined as part of Budget 2019. Cabinet Office circular CO (18) 2 states that 'any funding proposal submitted to Cabinet outside of the Budget process must not have been previously considered and declined by Cabinet'. This rule is in place to avoid agencies and Ministers 'appealing' Budget decision making, and undermining the integrity of the Budget decision-making process. It does not appear that circumstances have significantly changed to justify reconsideration of this proposal as an urgent item that cannot be deferred until Budget 2020 – particularly given Cabinet decisions will not be made on the wider three waters regulatory and service delivery changes until late in 2019".

Financial implications

91. Cabinet Office Circular CO (18) 2, *Proposals with Financial Implications and Financial Authorities*, requires that proposals for funding from the between-Budget contingency demonstrate that the proposal cannot be funded through reprioritisation, cannot be deferred until the next Budget, and should be supported with the same degree of information as a Budget proposal.
92. The Department of Internal Affairs has reviewed options for reprioritising funding from within Vote Internal Affairs baselines of the fiscal forecast period. I am advised that, although Budget 2019 initiatives have provided some relief for departmental cost pressures, significant cost pressures remain an issue for the Department to manage over the forecast period. These cost pressures have been largely driven by increased demand for Crown-funded services, and the required investment to meet service delivery expectations. As such, I am advised that the costs to undertake my proposed programme of work cannot be met within the Department's existing baselines.
93. The funding in 2019/20 of \$5 million is urgently needed to support councils in investigating voluntary collaboration, and to inform the Government's thinking on the need for statutory change, before any decisions are made on other changes to water service delivery arrangements. These further decisions will likely be made in 2020. Approval of funding therefore cannot be deferred to Budget 2020.
94. Accordingly, I am seeking approval for a \$5 million increase to the Vote Internal Affairs appropriations in 2019/20 to support and incentivise four to six regions/sub regions in their investigations of collaborative water service delivery arrangements. The fund would be approved for draw down by myself, the Minister of Finance and the Minister of Internal Affairs.

Human rights

95. There are no human rights implications arising from the proposals in this paper.

Legislative implications

96. There are no direct legislative implications arising from this paper. However, the accompanying paper – *Strengthening the regulation of drinking water, wastewater and stormwater* – contains a suite of proposals that would be implemented through a water services bill. A regulatory impact analysis is attached to that paper.

Publicity

97. 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

98. The Minister of Local Government recommends that the Cabinet Economic Development Committee:
1. **note** that a strategy for three waters reform was agreed by Cabinet in November 2018;
 2. **note** that the first part of delivering this strategy is regulatory reform, and that agreement to a package of policy proposals is being sought in the accompanying paper, *Strengthening the regulation of drinking water, wastewater and stormwater*;
 3. **note** that some smaller communities are not well-positioned to respond to the proposed reforms and to deliver quality three waters infrastructure and services, and there will be a need to address the funding challenges that are facing these communities;
 4. **note** that some regions are investigating options for making voluntary changes to local water service delivery and funding arrangements, but would benefit from help to progress this work, through financial assistance and the removal of barriers created by legislation;
 5. **agree** to establish a fund to support work with regions on voluntary changes, which would be approved for draw down by the Minister of Local Government, Minister of Finance and Minister of Internal Affairs;
 6. **note** that this fund would be expected to come from a predicted underspend in the 2019/20 Rates Rebate Scheme;
 7. **note** that there are links and overlaps between the Three Waters Review and the Essential Freshwater programme, and these programmes need to continue to be closely aligned;
 8. **note** that the more that the three waters proposals are designed to uphold Te Mana o te Wai and to reflect Māori interests, the better positioned Māori and the Crown will be when it comes to discussing Māori rights and interests in the Essential Freshwater programme;
 9. **agree** to increase funding in Vote Internal Affairs in 2019/20 to support and incentivise four to six regions/sub regions in their investigations of collaborative water service delivery arrangements;

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10. **approve** the following changes to appropriations to meet the costs associated with supporting regions to proceed with voluntary changes to service delivery arrangements, with a corresponding impact on the operating balance and net core Crown debt:

Vote Internal Affairs Minister of Internal Affairs	\$million - increase/(decrease)				
	2019/20	2020/21	2021/22	2022/23	2023/24 & Outyears
Multi-Category Expenses and Capital Expenditure: Policy Advice MCA Departmental Output Expense: Policy Advice -Local Government (funded by revenue Crown)	0.800	-	-		-
Non-Departmental Other Expense: Miscellaneous Grants - Internal Affairs	4.200	-	-	-	-
Total Operating	5.000	-	-	-	-

11. **agree** that the proposed changes to appropriations for 2019/20 above be included in the 2019/20 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;
12. **agree** that the expenses incurred under recommendation 10 above be charged against the between-Budget contingency established as part of Budget 2019; and
13. **agree in principle** to transfer from 2019/20 to 2020/21 any underspend in the above appropriations, with the final amount to be confirmed as part of the 2020 October Baseline Update once the audited accounts for 2019/20 are available.

Authorised for lodgement

Hon Nanaia Mahuta

Minister of Local Government