8.3 THREE WATERS REPORT UPDATE

Report To:	Full Council
Meeting Date:	12 August 2021
Report Author:	Richard Kirby, Group Manager - Community Infrastructure
Report Number:	RCN21-08-4

1 Summary

1.1 The purpose of this report is to provide an update on the Three Waters Reform Programme being led by the Government. This report is the first of two reports that the Council will be considering prior to 1 October 2021.

1.2 A second report is proposed to be presented to a Full Council meeting towards the end of September 2021. This second report will provide more detail on the direct impacts of the Water Industry Commission of Scotland (WICS) assumptions on the Council's three waters and collate all the feedback that the Council wishes to present to Local Government New Zealand (LGNZ) and the Department of Internal Affairs (DIA) by 1 October 2021.

1.3 The New Zealand Government has initiated a wide-ranging reform of the three waters sector, which is ongoing in 2021 and intended for implementation 1 July 2024. Over the past two decades, there have been a large number of Government and sector reports dealing with the wide range of issues surrounding the New Zealand three waters sector.

1.4 In late December 2020, DIA issued a Request for Information (RFI) to all councils in the country. The RFI required the Council to input specific data related to the three water activities. This data was submitted in early February 2021 and then modelled and assessed by WICS.

1.5 In June 2021, the DIA released the WICS report. It built on the findings of the earlier report to provide a more up-to-date analysis.

1.6 In June 2021, concurrent with releasing the WICS report, DIA presented the proposed reform proposal. The proposal comprises several core components; the key component being the establishment of four statutory, publicly owned water services entities to provide safe, reliable and efficient water services. The governance structure for the four new Water Service Entities (WSEs) was also presented.

1.7 Most of the Tasman District has been included in Water Service Entity 'C'. Entity 'D" encompasses the entire Ngai Tahu Takiwa, which includes most of the South Island. The southern portion of the Tasman District is also within the Takiwa, including the townships of St Arnaud and Murchison. Marlborough District is similarly impacted by the Ngai Tahu Takiwa boundary.

1.8 On 15 July 2021, at the LGNZ Conference, the Government announced a financial support package of $2.5 billion to support the local government sector through the transition to the

new water services delivery system and to position the sector for the future. There are two broad components to this support package:

- $2 billion of funding to invest in the future of local government and community well-being, while also meeting priorities for government investment (the **"better off"** component) and;
- $500 million to ensure that no local authority is financially worse off as a direct result of the reform (the **"no worse off"** component).

1.9 When announcing the second tranche of funding the Government indicated that councils would have an opportunity to review the large amount of information and so that each council could provide feedback by 1 October 2021.

1.10 The purpose of this 'engagement' period to 1 October 2021 is to provide time for all local authorities to engage with and understand the large amount of information that has been released. It will also allow councils to take advantage of the range of engagement opportunities to fully understand the proposal and how it affects each local authority and its community, and to identify issues of local concern and provide feedback to LGNZ on what these are and suggestions for how the proposal could be strengthened.

1.11 The Council is not expected to make any formal decisions regarding the reform through this engagement period. This is an opportunity for the sector to engage with – and provide feedback on – local impacts and possible variations to the proposed reform package outlined by the Government.

1.12 The June 2021 report released by DIA has been transparent regarding the modelling and analysis carried out by WICS. In common with all models, the models used by DIA/WICS have several built-in assumptions that when taken together have produced the results.

1.13 WICS has developed and presented a dashboard for Tasman District. This outlines the outcomes of the assessment and analysis and the direct impact on the Council.

1.14 DIA has funded expertise to work through LGNZ to help councils interpret the WICS calculations and how these relate to the Council. Morrison Low (ML) undertook this review for Tasman District Council.

1.15 The ML report is based upon its review of public WICS reports and individual council models provided by WICS. In some cases, the approach or assumptions used by WICS are unclear; the ML report focuses solely on the information ML was able to access and interpret.

1.16 The ML report provides an overview of the three waters reform, some general commentary of the WICS analysis, the impact on household bills and a comparison of the key data presented.

1.17 The ML report also outlines the WICS assumptions under each of the following headings, provides commentary around those assumptions and the potential impact of those assumptions on the Council:

a) Investment projections for renewals, levels of service enhancements and growth investment.

b) Revenue - three waters debt to revenue ratio, revenue from households and the number of household connections;

c) Capital and operating efficiencies;

d) Sensitivity analysis.

1.18 The three waters assets proposed to be transferred to the new Crown entity are the water and wastewater and possibly stormwater treatment facilities, lagoons, pipes (water distribution network), pumps and all associated infrastructure that ratepayers and users have invested in over many years. This is not to be confused with the national debate on fresh water or water as a resource in general.

1.19 A second report is proposed to be presented to a Full Council meeting towards the end of September 2021. This second report will provide more detail on the direct impacts of the WICS assumptions on the Council's three waters and collate all the feedback that Council wishes to present to Local Government New Zealand (LGNZ) and the Department of Internal Affairs (DIA) by 1 October 2021.

2 Draft Resolution

That the Full Council:

1 receives the Three Waters Report Update report, RCN21-08-3; and

2 confirms continued engagement with the Department of Internal Affairs so that the Full Council can then make a more informed decision on Three Waters Reform at a future date and;

3 notes that further engagement be undertaken with Te Tau Ihu iwi to provide better understanding prior to any decision of the Full Council on the Three Waters Reform.

THREE WATERS REPORT UPDATE

3 Purpose of the Report

3.1 The purpose of this report is to provide an update on the Three Waters Reform Programme that the Government is leading. This report is the first of two reports that the Council will be considering prior to 1 October 2021.

3.2 This first report will provide background to the Three Waters Reform Programme. It contains specific details around the WICS assessment and analysis of the three waters in New Zealand. This report also reviews the WICS assumptions supporting their assessment and analysis and the impacts of those assumptions for the Tasman District.

3.3 A second report is proposed to be presented to a Full Council meeting towards the end of September 2021. This second report will provide more detail on the direct impacts of the WICS assumptions on the Council's three waters and collate all the feedback that Council wishes to present to Local Government New Zealand (LGNZ) and the Department of Internal Affairs (DIA) by 1 October 2021.

4 Background

Context

4.1 The New Zealand Government has initiated a wide-ranging reform of the three waters sector which is ongoing in 2021 and intended for implementation 1 July 2024. Over the past two decades, there has been many Government and sector reports dealing with the wide range of issues surrounding the New Zealand three waters sector.

4.2 The current reform was triggered by the Havelock North water supply incident in 2016 where contaminated groundwater entered the water network and led to 5,000 people falling ill and four consequential deaths.

4.3 The subsequent Government inquiry in 2017 observed that New Zealand had fallen well behind international best practice in the delivery of drinking water and made wide-ranging reform recommendations.

4.4 The Government received these recommendations and is acting on them in the current reform process.

4.5 In July 2020, the Government launched the Three Waters Reform Programme – a three-year programme to reform local government three waters service delivery arrangements.

4.6 At the same time, it announced a $761 million funding package to provide post COVID-19 stimulus to maintain, improve three waters infrastructure, support a three-year programme of reform of local government water service delivery arrangements (reform programme), and support the establishment of Taumata Arowai, the new Waters Services Regulator.

4.7 In August 2020, the Council approved the signing of a Memorandum of Understanding to remain engaged in the reform process. It was a non-binding commitment to receive initial funding for specific shovel-ready projects and continue to be involved in the reform process.

THREE WATERS REPORT UPDATE

4.8 The Council agreed to sign the MoU and consequently received funding of $9.78 million to be spent on approved water, wastewater and stormwater projects by March 2022. The Council is on track to spend this funding.

4.9 In December 2020, DIA released a report conducted by the Water Industry Commission for Scotland (WICS), commissioned as part of the programme.

4.10 This Phase 1 Report provided an early indicative view on the size of New Zealand's three waters infrastructure deficit and the potential benefits of reform. Local government representatives expressed concerns over the validity of parts of this analysis, which led to a request for information from councils on their three waters assets and services.

4.11 In late December 2020, DIA issued a Request for Information (RFI) to all councils in the country. The RFI required the Council to provide specific data related to the three water activities. This data was then modelled and assessed by the Water Industry Commission of Scotland (WICS). This was submitted in early February 2021.

4.12 In June 2021, the DIA released the WICS report. It built on the findings of the earlier report to provide a more up-to-date analysis. The key findings were in three parts:

- **Part 1** - The report's modelling indicated that a future investment of $120 billion to $185 billion will be necessary at a national level, for New Zealand to meet current levels of compliance that water utilities in the UK achieve with European Union (EU) standards, over the next 30 years. (These standards were assessed by WICS to be broadly comparable with equivalent New Zealand standards).
- **Part 2** - NZ's Three Waters sector is in a broadly similar position to Scotland in 2002, in terms of relative operating efficiency and levels of service. In just under two decades, Scottish Water lowered its unit costs by 45% and closed the levels of service gap on the best-performing water companies in the UK. WICS considers that New Zealand can achieve similar outcomes to Scottish Water over a longer period (30 years).
- **Part 3** - The WICS analysis showed that aggregation scenarios ranging from one to four entities provide the greatest opportunity for scale efficiencies and related benefits in terms of improved levels of service and more affordable household bills (when compared against the likely outcomes 'without reform').

4.13 An assessment of the WICS Report and its implications for the Council are outlined later in this report.

Government Reform Package

4.14 In June 2021, concurrent with releasing the WICS Report, DIA presented the proposed reform proposal. The proposal comprises the following core components:

a) establish four statutory, publicly owned water services entities to provide safe, reliable and efficient water services;

b) enable the water services entities to own and operate three waters infrastructure on behalf of local authorities, including transferring ownership of three waters assets and access to cost-effective borrowing from capital markets to make the required investments;

THREE WATERS REPORT UPDATE

c) establish independent, competency-based boards to govern each water services entity;

d) introduce mechanisms that protect and promote the rights and interests of iwi/Māori in the new three waters service delivery system;

e) introduce a series of safeguards against future privatisation of the water services entities;

f) set a clear national policy direction for the three waters sector, including expectations relating to the contribution by water services entities to any new spatial / resource management planning processes;

g) establish an economic regulation regime, to ensure efficient service delivery and to drive the achievement of efficiency gains and consumer protection mechanisms; and

h) develop an industry transformation strategy to support and enable the wider three waters industry to gear up for the new water services delivery system.

4.15 The governance structure for the four new Water Service Entities (WSEs) and how the WSEs relate to other entities is included in **Diagram 1, Attachment 1.**

4.16 Most of the Tasman District Council has been included in Water Service Entity ‘C’. **Diagram 2, Attachment 1** details the boundaries of the four Water Services Entities across New Zealand. Most of Tasman District is included in WSE C along with the Top of the South councils, the Wellington councils, Kapiti Coast councils, Manawatu councils and all councils on the east coast of North Island from the Wairarapa up to and including Gisborne District Council.

4.17 You will note from Diagram 2, that WSE ‘D’ takes the southern portion of the Tasman District, primarily the portion within the Ngai Tahu Takiwa. This comprises St Arnaud and Murchison. Marlborough District has had a similar portion included in the Ngai Tahu Takiwa.

4.18 This is a point of discussion for the Council. The Tasman District residents within the Ngai Tahu Takiwa and particularly those in St Arnaud and Murchison who receive water and wastewater services from the Council, are more likely to have a community interest with Tasman and Nelson than with other parts of the South Island.

4.19 The Mayors of Nelson, Tasman and Marlborough met with iwi chairs prior to decisions being made to invite their input on the options of being aligned to a South Island Entity or North. Feedback showed a preference to be aligned to the South Island and iwi advised that they would progress this discussion with the Minister

4.20 The Mayors and Chief Executives of the three Te Tau Ihu Councils (Tasman, Nelson and Marlborough) met informally with the Local Government Minister in Blenheim on Wednesday 14th July. The Minister had met with iwi the day before. Minister Mahuta stated that the government’s preference was that Te Tau Ihu not be included in the entity covering the Ngai Tahu Takiwa. The Tasman and Marlborough District Councils expressed their desire that for whichever entity they were allocated, the whole territorial authority should be included and not split as proposed by the government.

4.21 In providing feedback to government by the end of September, further clarification with Te Tau Ihu iwi regarding their views will be important.

Financial Support Package

4.22 On 15 July 2021, at the LGNZ Conference, the Government announced a financial support package of $2.5 billion to support the local government sector through the transition to the new water services delivery system and to position the sector for the future. There are two broad components to this support package:

- $2 billion of funding to invest in the future of local government and community well-being, while also meeting priorities for government investment (the **"better off"** component) and;
- $500 million to ensure that no local authority is financially worse off as a direct result of the reform (the **"no worse off"** component).

4.23 The **"better off"** component of the support package, which comprises $1 billion Crown funding and $1 billion from the new water services entities, is allocated to territorial authorities based on a nationally consistent formula that takes into account population, relative deprivation and land area. This formula recognises the relative needs of local communities, the unique challenges facing local authorities in meeting those needs and differences across the country in the ability to pay for those needs.

4.24 An indicative amount of **$22,542,967** has been allocated from this **"better off"** funding should Council continue to be involved in the three waters reform programme. There are criteria on when and how this funding will be released.

4.25 Councils will be required to demonstrate that the use of this funding supports the three waters service delivery reform objectives and other local wellbeing outcomes and aligns with the priorities of central and local government, through meeting some or all of the following criteria:

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

4.26 The **"no worse off"** component of the support package is intended to address the costs and financial impacts on territorial authorities directly because of the three waters reform programme and associated transfer of assets, liabilities and revenues to new water services entities. It includes an allocation of up to $250 million to support councils to meet unavoidable costs of stranded overheads, based on:

- One hundred and fifty million dollars ($150 million) allocated to councils (excluding Auckland, Christchurch and councils involved in Wellington Water) based on a per capita rate that is adjusted recognising that smaller councils face disproportionately greater potential stranded costs than larger councils;
- Up to $50 million allocated to the Auckland, Christchurch and Wellington Water councils excluded above based on a detailed assessment of two years of reasonable and

unavoidable stranded costs directly resulting from the Water Transfer, as the nationally-consistent formula is likely to overstate the stranded costs for these councils due to their significantly greater scale and population. Stranded costs should be lower with respect to Watercare and Wellington Water as these Council Controlled Organisations have already undertaken a transfer of water services responsibilities, albeit to varying degrees; and

- Up to $50 million able to be allocated to councils that have demonstrable, unavoidable and materially greater stranded costs than provided for by the per capita rate (the process for determining this will be developed by the Department of Internal Affairs working closely with Local Government New Zealand).

4.27 The remainder of the no worse off component will be used to address adverse impacts on the financial sustainability of territorial authorities. This will require a due diligence process that will need to be worked through in the coming months.

4.28 In addition to the support package, the Government expects to meet the reasonable costs associated with the transfer of assets, liabilities and revenue to new water services entities, including staff involvement in working with the establishment entities and transition unit and provision for reasonable legal, accounting and audit costs. There is an allocation for these costs within the $296 million tagged contingency announced as part of the 2021 Budget package for transition and implementation activities. This allocation is additional to the $2.5 billion support package.

4.29 DIA is continuing to work with LGNZ and Taituarā (previously Society of Local Government Managers), including through the joint Steering Committee process, to develop the process for accessing the various components of the support package outlined above, including conditions that would be attached to any funding. More information and guidance will be made available in the coming months.

Implications for Council Staff and Contractors

4.30 While no decisions have been taken on whether to proceed with the reforms as proposed, Council staff/contractors that work in the three waters need certainty under the reforms. DIA and LGNZ have been working together to develop principles to provide early certainty for existing Council-employed staff regarding their ongoing role.

4.31 DIA and LGNZ consider that the water service delivery reforms (if it proceeds) will provide real opportunities to workers, both through increased career opportunities and in removing any systemic issues that have been constraining their ability to deliver water services at a level that is in the best interest of their communities.

4.32 A major focus of both central and local government is on ensuring that reform does not result in a loss of current staff, but in fact creates a platform to attract, develop and retain talent and enhance local expertise.

4.33 DIA has confirmed that any member of staff who works primarily within the three waters will be guaranteed a role in the new WSEs whilst retaining key features of their current role, salary, location, leave and hours/days of work. A more bespoke approach is required for senior executives, other staff and contractors. DIA will work with councils, staff, and unions further on this through the transition.

4.34 DIA has stated that it wants to provide as much certainty as possible, noting there is still more work to do. These workers should be assured that their wellbeing is a critical objective for both central and local government.

Opportunity for Council Consideration and Feedback

4.35 When announcing the second tranche of funding, the Government indicated that councils would have an opportunity to review the large amount of information, so that each council could provide feedback by 1 October 2021.

4.36 The purpose of this 'engagement' period to 1 October 2021 is to provide time for all local authorities to:

- engage with and understand the large amount of information that has been released on the nature of the challenges facing the sector, the case for change, and the proposed package of reforms, including the recently announced support package;
- take advantage of the range of engagement opportunities to fully understand the proposal and how it affects its local authority and its community; and
- identify issues of local concern and provide feedback to LGNZ on what these are and suggestions for how the proposal could be strengthened.

4.37 The Council is not expected to make any formal decisions regarding the reform through this engagement period. This is an opportunity for the sector to engage with – and provide feedback on – local impacts and possible variations to the proposed reform package outlined by the Government.

4.38 Following the engagement period, the Government will consider the feedback and suggestions provided by local authorities, in partnership with the joint steering committee. It will also consider the next steps, including the transition and implementation pathway and revised timing for decision-making, which could accommodate the time required for any community or public consultation.

4.39 LGNZ has confirmed that the Government will not be taking further decisions until after this engagement period.

4.40 The Government signalled earlier this year that council's 'opt-in' or 'opt-out' decision on the reforms would need to be made around November/December 2021. We understand this is still the intention. That being the case, unless there is a change to this timeline it is unlikely that councils will have the opportunity to consult with its communities. This is something that has been raised with the Government as a key issue.

4.41 In the coming months Council will need to reach a conclusion on 'opting in' or 'opting out', unless the government decides an all-in approach is to be applied.

4.42 Opting in would result in the transfer of all drinking water, wastewater and stormwater assets including all field operations from the Council to the new Water Service Entity 'C'. Indications are that any debt or financial reserves associated with the three waters will also be transferred. The details around how these are assessed and transferred is still to be determined.

THREE WATERS REPORT UPDATE

4.43 Opting out will result in status quo; that is Council retaining all the three water activities it has now. However, in opting-out Council will be subject to;

a) Taumati Arowai (Water Regulator);

b) The Water Services Act once enacted;

c) Economic Regulator – although this role has not been established yet, indications are that it will be established to manage charging regimes and investment requirements for all Water Supply Authorities whether WSEs or Councils.

d) Increased costs associated with meeting these statutory requirements.

Waimea Community Dam

4.44 While the transition to the new WSE 'C' is still subject to decisions, early indications remain that the Council's interest in the Waimea Community Dam and the associated debt will transfer to the new WSE 'C'.

4.45 DIA are engaging constructively with Council staff to understand the cost allocation, debt model and undertake further due diligence. At this stage DIA has advised that there would be no anticipated scenario where Tasman District Council retain part ownership of the Dam i.e. Tasman District Council, the new WSE and Waimea Irrigators Ltd in a tripartite partnership.

4.46 It is envisaged that the Council's shareholding of the Dam would lift and shift into the new WSE and that Waimea Irrigators Ltd would retain their current shareholding and rights under the project agreements.

4.47 DIA will be undertaking due diligence before finalising any decisions with Ministers.

5 Water Industry Commission of Scotland (WICS) Assessment and Modelling

DIA/WICS Model Assumptions

5.1 The June 2021 report released by DIA has been transparent about the modelling and analysis carried out by WICS. In common with all models, the models used by DIA/WICS have several built-in assumptions that, when taken together, have produced the results. As already stated in section 4.12 above, potentially there are very large future costs being presented as a result of these assumptions and modelling.

5.2 The assumptions are made on a New Zealand wide basis and may not necessarily be valid for the Tasman District specifically. The major assumptions in the WICS/DIA Model are:

a) Use of UK Econometric models developed in 2003-04;

b) Use of same service level standards as the UK (i.e. European water and discharge standards);

c) Growth investment was modelled on 95% population coverage of public water supplies (NZ is currently 80%);

d) A cap of $70,000 debt per connected citizen was included in the model based on observed levels of spending in Scotland on rural areas;

e) 30-40% efficiency gain for large multi-regional entities with 800,000+ population;

f) No efficiency gains for local authorities with population 60,000 or less;

g) Better debt raising ability for large multi-regional entities with lower interest rates;

h) Capped debt raising for local authorities are 2.5 times revenue.

5.3 Running the models for 30 years with these assumptions embedded, has resulted in the very large numbers presented. This is exacerbated with the growth model assuming 15% more coverage by water supply systems in a sparsely populated country i.e. increasing the current 80% to 95% coverage of public water supplies.

5.4 Independent reviews of the DIA/WICS modelling were undertaken by Farrierswier and Beca. These reviews were generally supportive of the model scope and direction however they did raise a range of issues with the model application. Whilst technical in nature, these issues could have large impacts on the currently published model results – particularly in provincial and rural areas of the South Island.

WICS Dashboard for Tasman District Council

5.5 WICS has developed and presented a dashboard for Tasman District. This outlines the outcomes of the assessment and analysis and the direct impact on the Council. The dashboard is shown in Figure 2 (clause 6.17) below and is summarised as follows:

- Economic

  GDP Growth

  - low scenario 5.7%
  - high scenario 9.1%
  - Under the Low Scenario, the reforms are forecast to grow Tasman's GDP by 5.7% over 30 years as a proportion of Tasman's current GDP. This increases to 9.1% under the High Scenario. This compares to 4.4% across New Zealand under the Low Scenario and 7.1% under the High Scenario

  Employment Growth

  - low scenario 0.2%
  - high scenario 0.3%
  - Under the Low Scenario, job growth in Tasman is forecast at 0.22% of the current workforce each year as a result of the reforms (versus 0.26% for New Zealand). Under the High Scenario this increases to 0.34% for Tasman versus 0.41% for New Zealand.

- Operations

  - Three Waters FTEs = 86 (assessment of staffing requirements by July 2024 should Council opt out. This is an additional 29 FTEs or a 50% increase on current FTE levels. This includes all staff involved in the delivery of the three water activities. Currently the staffing levels are around 23 internal FTEs and 34 external FTEs = circa 57 FTEs as at June 2021).

  - Distribution Zones = 4 (reporting on determinand failures: determinands are measured characteristics or properties of water that adversely affect taste, odour, colour, chemical composition, turbidity or general appearance).

- Financial
  - 2021 Average cost/household = $2,290 per year (based on RFI Data)
  - 2051 Average cost/household = $6,760 per year (no reform)
  - 2051 Average cost/household = $1,260 per year (with reform)
- Number of billed properties
  - Water = 13,925
  - Wastewater = 14,526
  - Stormwater = 15,450
- Population affected by water restrictions = 85%
- Population change (summer vs winter) = 87%
- Properties affected by unplanned interruptions = 5,000
- Total unplanned interruptions = 221
- Performance = 3 (1 = Leading, 2 = Exceeding expectations, 3 = performing in line with expectations and 4 performing below expectations)

5.6 WICS presented the figures in this dashboard after applying the assumptions listed above.

6 Review of WICS Data – Morrison Low Report (Attachment B)

Introduction

6.1 DIA has funded expertise to work through LGNZ to help councils interpret the WICS calculations and how these relate to each council. Morrison Low (ML) undertook this review for Tasman District Council. Most of the commentary in the Morrison Low Report is included in this report, however a copy of the Morrison Low Report is in **Attachment 2**.

6.2 The ML Report is based on its review of public WICS reports and individual council models provided by WICS. In some cases, the approach or assumptions used by WICS are unclear; the ML Report focuses solely on the information ML was able to access and interpret.

6.3 It is also important to highlight that there is no connection between the WICS analysis and the Government's wider support package including calculation or allocation of the 'no-worse off' and 'better off' parts of the package.

6.4 The data in the dashboard is a combination of calculated information (household charges) and data straight from the Council's RFI.

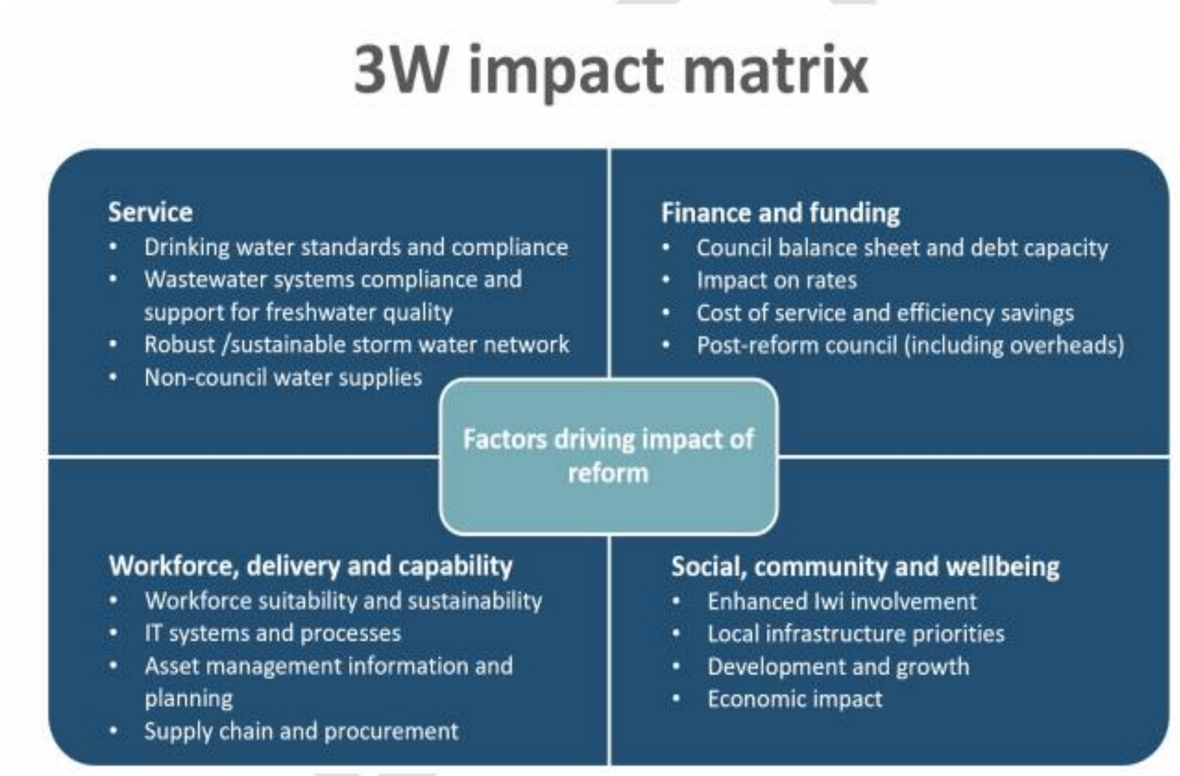
Three Waters Reform

THREE WATERS REPORT UPDATE

6.5 While the ML Report concentrates on the financial analysis recently provided in the Council dashboards, it is important to highlight that this is only one part of the wider suite of information that councils need to consider when looking at the proposed reforms. The impacts, benefits, issues and risks of reform are far wider ranging than just the financial impacts.

6.6 LGNZ has developed a matrix shown in Figure 1 below which highlights the broad considerations each council should be considering and in ML's view this represents a good starting point. This helps ensure that benefits, issues and risks around levels of service, capability and capacity, prioritisation of investment and impacts on communities and councils are also considered alongside the financial.

Figure 1 Understanding the impacts (LGNZ)



6.7 ML also note that because of the three waters work that they have undertaken across New Zealand over the last 18 months, it is likely that the future household costs for three waters will increase significantly for all councils because of meeting increased standards, regulations and satisfying a more rigorous compliance regime. ML's view is that the future costs may not be as high as modelled by WICS but the direction is the same.

WICS Analysis

Scenarios

6.8 Broadly, WICS compares two scenarios:

- Aggregation of three waters services into four water services entities and the associated reforms to the regulatory, governance, management, resourcing, and policy direction that support improvements ('the whole reform package');

- No aggregation of three waters services and although in this scenario some reform takes place, for example, decisions already made to introduce a drinking water regulatory system and environmental standards, the wider reforms are not as extensive as in the former scenario.

Assumptions

6.9 The assumptions WICS have used to quantify the inputs are determined through benchmarking against the UK experience. Whilst there has been some adjustment based on council feedback the potential investment requirements and ability to deliver the same efficiency gains, both key drivers of the analysis, may not be comparable in the New Zealand context.

6.10 The key assumptions that drive household costs are:

- Investment – this is the single biggest driver of household cost in the WICS model. Due to the way it is calculated at a national level and allocated at entity level and council level, it is difficult to understand the impacts it makes on the difference on the household charges under the two scenarios. Any change at the national investment figure will have a material impact on household charges in both scenarios.
- Debt/Revenue – the difference between the treatment of debt in the councils and the entities means that it is likely to overstate the size of the difference in charges between council and the water service entity.

6.11 The impact of these is so significant that all other assumptions have minimal impact on household costs.

6.12 The WICS analysis has been completed using a different approach, and different assumptions to those ML used in an earlier business case undertaken for the three waters reform in New Zealand. ML note that despite the differences in its analysis and the WICS analysis they are directionally consistent. That is, in both cases it is anticipated that there are significant three water investment requirements to meet the new standards and this will lead to substantial increases in the cost of services.

6.13 A key risk is that the investment level in three waters could be greater than forecast. The WICS forecast investment articulates this risk. ML's earlier business case also identified that an aggregated three waters entity was the option that best protected all ratepayers from the costs of meeting that risk.

Timeframes

6.14 WICS have undertaken the analysis over the 30-year time horizon. Responses to the RFI across the country were not consistent, where councils did not provide 30-year information, ongoing investment in growth infrastructure is assumed at the level of the final year in the data set. Undertaking future economic analysis based on a 30-year forecast is notoriously difficult especially in the context of the quality of the existing asset data. Additionally, this assumes capital expenditure follows a linear trend however we know that investment in three waters infrastructure tends to vary.

Impacts on Household Bills

THREE WATERS REPORT UPDATE

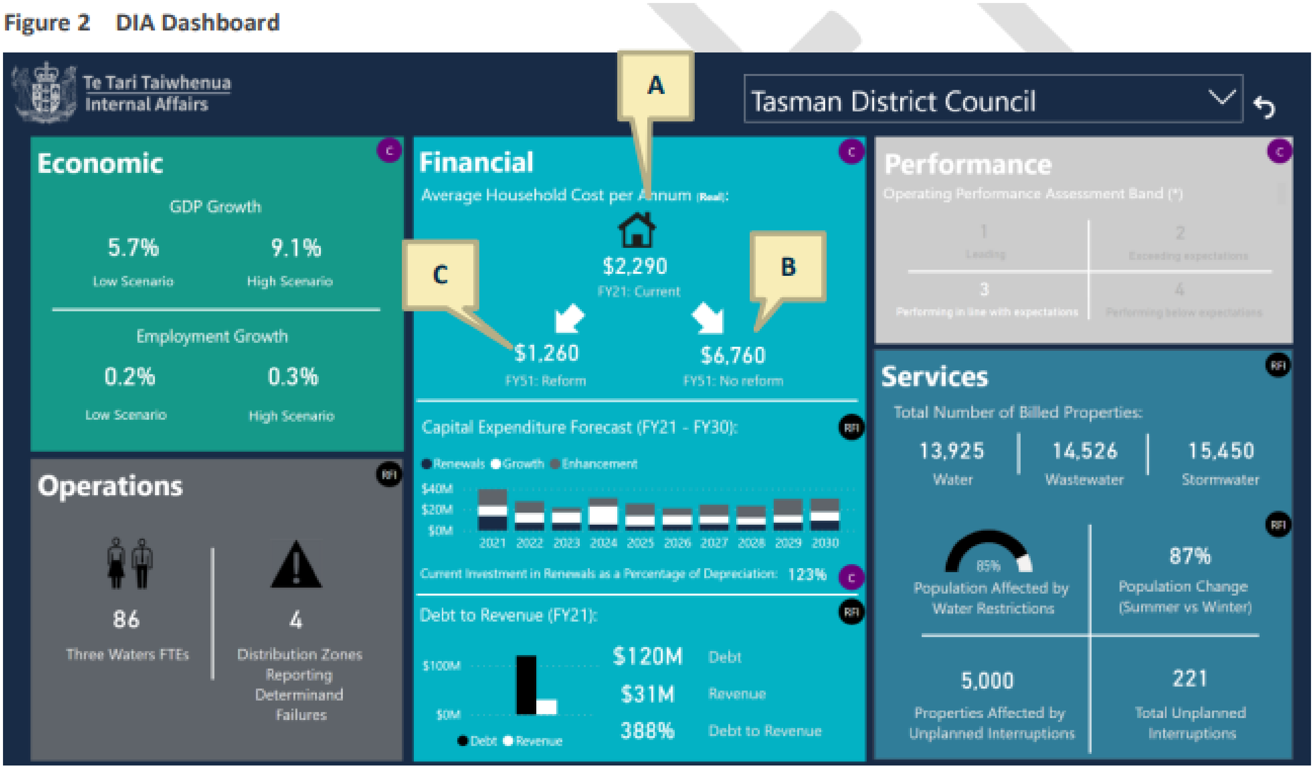
6.15 WICS have used an average household charge as the key piece of information for councils and communities.

6.16 The Tasman District dashboards provided by DIA present three different average household costs, represented as A, B and C in Figure 2 below:

- **A** – represents the estimated average household cost using WICS modelling approach, this is not representative of actual charges.
- **B** – represents the projected future household charge in 2051 without reform.
- **C** – represents the projected future household charge in 2051 under the proposed Entity for your council, Entity C, with water reform.

6.17 These numbers are expressed in real terms, they are uninflated and expressed in today's dollars. The approach used by WICS to determine these values is outlined below.

Figure 2 DIA Dashboard



A = $2,290 per household per year (2021)

6.18 To estimate current household charges for each council, WICS have:

- Taken the starting total three waters revenue collected by the council (including development contributions but excluding grants and subsidies);
- Multiplied that figure by 70% - which is their assumed percentage of revenue derived from households. We have noted that the 70% does generally align with the majority of councils, however some councils' revenue from households is higher and some lower;

- Divided that figure by the estimated number of household connections, which in turn is derived from:
    - The average of the connected drinking water and wastewater populations. The model does not use actual household connection as identified in the RFI or use stormwater connections.
    - Divided by a standard "household density" multiplier of 2.7.

B = $6,760 per household per year (2051 – no reform)

6.19 The process used by WICS to estimate future household charges is the same as outlined above, using estimated future revenue requirements and estimated future household connections (which allows for growth in connections).

6.20 To determine the future household charge WICS have:

- Calculated the future required investment in growth, level of service enhancement and renewal of assets.
    - Growth investment is assumed to be the same as disclosed in each council's RFI, with the same annual average expenditure applied across the full 30-year period if a council only disclosed 10 years of projected investment.
    - Renewal investment is assumed to be 100% of the economic depreciation of assets. WICS have undertaken their own calculation of economic depreciation based on assumed asset values and lives.
    - Level of service enhancement investment has been calculated using a standard approach across the country that has regard to population, land area and density. It does not reflect each council's actual investment set out in the RFIs.
- WICS have recalculated depreciation, this has increased council figures.
- Determined the impact of new investment on operating expenditure. WICS has assumed that for every $100 of capital investment there is $3 of additional operating costs. WICS have also included additional depreciation and financing costs for new assets.
- Determined the amount of new borrowings required to finance their modelled investment profile.
- Determined the amount of revenue that needs to be collected to ensure that councils can maintain a three waters debt to three waters revenue ratio of less than 250% over the modelling period. This is the revenue number that is divided by WICS' estimated future household connections to reach the household charges at B above.
- This revenue number typically results in operating surpluses being generated which are applied toward debt reduction.

C = $1260 per household per year (2051 with reform)

6.21 WICS have undertaken the same modelling to estimate the future household charges for ratepayers of a council area if water reform entities were formed. The result reported in each council's dashboard (C) matches the projected future household charges for all councils in Entity C (of which Tasman District Council is a part) in 2051.

6.22 ML has not reviewed (and have not been provided with) financial or economic models for any of the proposed water services entities, however ML anticipates that the approach used to project future household charges for water services entities is closely aligned to that used to project future household charges for individual councils. The differences are likely to be in the assumptions applied, in particular:

- Entities have been modelled with no limit on the debt to revenue ratios (or no discernible limit). This means that WICS reports show the projected debt level for WSE C is allowed to nearly reach 800% of revenue by 2051. This accounts for a substantial part of the difference between the projected three waters rate for each council and Entity C in 2051.
- Entities have been assumed to be able to generate efficiencies amounting to 45% by 2051. By way of contrast, Tasman District Council has not been provided any allowance for potential operating of capital efficiencies. This accounts for most of the remaining difference between the projected three waters rates.
- Finally, the entity will benefit from the scale of aggregation. That is, the total revenue needs will be spread over a larger population base. The extent to which this scale benefit applies to a particular council will vary depending population and land area.
- It is unclear whether the total investment requirements for WSE C, including depreciation and renewals investment, have been derived by adding the constituent parts of each council, or by undertaking new calculations using the population, land area and density of the new water services entity. Each approach is likely to have different results.

Comparison of Key Data from WICS

6.23 The following section compares data from the WICS model to that within Tasman District Council's RFI.

6.24 The comparison highlights that WICS has modelled level of service and growth investment that is over three times larger than the investment requirements identified by the Council in its completed RFI. For the Council, this is the most significant driver of the household charge calculations produced by WICS. The assumption of staying below a three waters debt/revenue ratio of 250% also drives a significantly higher three waters household charge than if debt/revenue was viewed at the total Council level.

Household Cost per annum

Item	WICS Council		WICS Entity		Comments on Assumptions
	2031	2051	2031	2051	
Household Charge (uninflated)	$6,253	$6,760	$1,255	$1,255	WSE Option shows significantly lower charge per household

THREE WATERS REPORT UPDATE

Investment				
Item	WICS Council		RFI (2031)	Comments on Assumptions
	2031	2051		
Total Investment Requirement	$856,203,496	$3,042,030,900	$263,063,000	WICS model projects significantly higher investment need
Levels of Service Enhancement & Growth	$657,528,347	$1,972,585,042	$198,127,000	WICS model projects significantly higher LOS enhancements and Growth needs
Total Renewals/Capital	$198,675,149	$1,069,445,857	$64,936,000	WICS show significantly higher level of Renewal requirements

Valuations and Depreciation			
Item	WICS Council	RFI (2031)	Comments on Assumptions
Asset value	$821,677,769	$681,440,000 (low) $885,870,000 (high)	Higher asset values become more relevant over time
Depreciation	$11,188,141	$8,929,500	*Depreciation is 44% higher under the WICS model at start and becomes more material as investment in assets increase *Implied depreciation rate WICS = 1.35% increasing ot 1.74% over tiem. RFI 1.14% *Includes 50% depreciation charge for NRSBU 50% owned by Council

Revenue					
Item	WICS Council			WICS Entity	Comments on Assumptions
	2021	2031	2051	2031	
Total Debt	$120,000,000	$423,891,509	$1,253,173,058	$148,177,000	WICS project debt to be significantly higher than in RFI
Total Revenue	$31,000,000	$173,637,121	$504,180,096	$56,336,000	WICS projects revenue to be significantly higher than in RFI
Debt to Revenue	388%	244%	249%	263%	Charges increase to bring ratio back within the 250% under the WICS model so comparison not relevant
Operating Surplus	N/A	$64,306,586	$107,650,110	N/A	Only exists under WICS model

Item	WICS Council	RFI		Comments on Assumptions
Revenue from Household	70%	70%		As Tasman collects a similar percentage from household charges compared to the WICS Model assumptions
Connected Household Properties	11,606	Water	12,123	*Number of connected properties is lower in the WICS model, the chrages are likely to be slightly lower than reported by WICS
		Wastewater	13,303	
		Stormwater	14,124	*Not as material as other assumptions
Development Contribution	WICS assumes that DCs when combined with revenue from commercial& industrial users account for less than 30% of total three waters revenue	DCs in 2031 equate to 11% of total three waters revenue		WICS effectively incorporates DCS within its modelling. The assumption is not material

7 WICS Commentary – Morrison Low Report

Investment Projections

THREE WATERS REPORT UPDATE

7.1 Investment is the single biggest driver of cost in the WICS model. WICS estimates the potential investment requirement over the next 30 years for each council. This is considered for:

(a) Renewals (Replacement and Refurbishment);

(b) Levels of Service (Enhancement);

(c) Growth investment.

7.2 These three values are combined to determine a total investment programme for each council.

7.3 The following sections outline the WICS assumptions, then provides commentary and potential impact of those assumptions.

(a) Renewals (Replacement and Refurbishment)

7.4 In their various reports, WICS noted that based on a review of completed RFI's and comparison to their international benchmarks:

- Asset values reported by New Zealand councils were typically low.
- Useful lives appeared to be optimistic.
- The split of asset value between short lived (less than 30 years) and long lived (estimated lives of around 100 years) was more heavily weighted toward long lived assets.
- Using the low range for asset values and the high range for asset lives (i.e. the two extremes) disclosed in RFI would increase the risk that there is insufficient resources available for asset replacement.

7.5 Based on their observations WICS therefore recalculated the depreciation for each council's asset base, assuming:

- Ninety percent (90%) of existing assets are long life assets with an estimated life of 100 years.
- Ten percent (10%) of existing assets are short life assets with an estimated useful life of 30 years.
- Long life assets were assumed to have a valuation at the mid-point of the low and high end valuations disclosed in RFIs.
- Short life assets were assumed to have a valuation at the upper range of the valuations disclosed in RFIs.
- New investment is assumed to comprise 60% short life assets and 40% long life assets to enable the long/short life split of assets to eventually reach the international benchmark of 30% short life and 70% long life assets.

7.6 WICS has then modelled investment in renewals at 100% of depreciation throughout the modelling period. There has been no adjustment to planned renewals investment to reflect that some investment in level of service enhancement or growth is likely to also have a renewals component.

7.7 The modelled renewals investment is likely to differ substantially to renewals programmes that have been calculated by each council.

7.8 WICS have modelled an effective starting average depreciation rate of 1.35% of the revised asset value. This depreciation rate increases over the modelling period to eventually reach 1.75%. These depreciation rates translate to an average useful life for three waters assets of 81 and 59 years, respectively.

Comments on Renewals Underlying Assumptions

7.9 ML notes that WICS calculation of renewals expenditure and depreciation does not consider:

- The relative age profile of each council's network and each council's stage in the asset lifecycle.
- The amount of investment in level of service enhancing infrastructure or growth infrastructure which may also have a renewals component.
- The actual split of long life and short life assets within each council and the specific circumstances that give rise to that split (e.g. water networks with large distribution zones and therefore a higher proportion of reticulation assets which are typically long life, or the inclusion of stormwater assets which typically have longer lives and do not form part of the Scottish water asset base).

7.10 ML notes that the depreciation rate of 1.35% is broadly within the high end of the range observed in New Zealand already. However, the longer term depreciation rate of 1.75% is much higher than most councils in New Zealand (although this is intended by WICS).

7.11 While the rate of depreciation may be consistent with the New Zealand average, the valuation of assets is not. In ML's experience, councils typically value their assets at the low end of the valuation range provided in their completed RFIs. This means WICS has typically increased the total depreciation charge above those that are likely to be included in long term plans.

7.12 ML are aware of a number of recent examples where councils that have had recent asset valuations have experienced substantial uplifts in assets value. This may support WICS assumptions around asset valuations. Tasman District Council's valuations were completed as at 30 June 2020.

Potential Impact of Renewals Assumptions

7.13 Overstatement of the renewals requirement will result in an overstatement of debt and revenue projections for the entity.

7.14 This assumption is likely to affect the entity and council projections equally, so will likely have limited bearing on the comparative outcomes of household charges. However, it will have a significant impact on the projected household charges for councils in 2051 if reform does not occur.

(b) Levels of Service Enhancement and (c) Growth Investment

7.15 The various reports produced by WICS outline three different approaches used to determine the future required investment in level of service enhancement (and in some cases growth expenditure):

- based on relationships between historical enhancement and growth investment in the UK (same approach as Phase 1 but updated using council RFI information);
- based on relationships between historical enhancement and growth in Scotland only (i.e. using the same approach as in Phase 1 but with Scottish data only); and
- based on the observed gap in asset values per connected system between New Zealand and the UK – this approach does not account for growth.

7.16 While the approaches differ in how they arrive at their estimates, they deliver broadly consistent results in terms of the magnitude of investment that is likely to be required over the next 30+ years. It indicates that to meet quality and growth outcomes, spending will need to more than double from current levels over the next 30 years.

7.17 WICS note these figures could ultimately be even higher as they do not take account of investment uncertainty associated with the need to provide for seismic resilience, climate change, or responding to changing societal standards around environmental impacts (including iwi/Māori expectations).

7.18 It is unclear which of these approaches was used to identify the potential amount of level of service enhancement investment needed. However, ML understand that the outcome under all three approaches is broadly similar.

7.19 WICS also applied two further adjustments:

- it appears that planned investment in growth infrastructure was effectively removed from the results in favour of using council's own projections for investment in growth infrastructure. Where councils only reported forecast investment for a 10-year period this was assumed to be representative of the next 20 years as well.
- applied a cap of NZ$70,000 per head for combined investment in level of service enhancement and growth infrastructure across any council area, this limits the modelled potential exposure of most rural councils.

7.20 WICS does disclose some of the formulas that it has used to identify potential investment requirements, although without knowing the source of the variables used within the formulas, we have been unable to replicate the results. We note however that the formulas (at least at a national level) do include length of waterways and coastline, so may make some attempt at incorporating relevant environmental factors.

7.21 However, at an individual council level, the investment numbers produced by WICS are based on population, land area, and density alone and have no relationship to each council's:

- Type, quality, or number of water sources
- Receiving environment for wastewater discharges
- Current treatment approach
- Current levels of service
- Asset age

- Asset performance
- Asset condition

Comments on Underlying Assumptions for Levels of Service Enhancement and Growth Investment

7.22 Investment is the single biggest driver of cost in the WICS model. It is what drives the future borrowing requirement, which in turn determines the amount of revenue that needs to be collected. That means that if the future investment requirements in the WICS modelling are under or overstated, the future household costs are likely to be similarly impacted.

7.23 Despite this it is worth recognising that predicting future investment requirements is notoriously difficult. This is particularly true over long timeframes, such as the 30-year period that has been modelled by WICS.

7.24 While predicting investment over a 10-year period is more certain, even this is challenging, as demonstrated by the long-term plans of almost every council in New Zealand. Long term plans often have significant uplifts in their ten-year capital works programmes despite being only 3-year cycles.

7.25 ML has not attempted to make an alternative assessment of 30-year investment requirements and therefore have no view on whether the projected investment by WICS is appropriate. However, as it appears that a different approach may have been used to determine investment at a national scale than that used at a council level, even if the national, or regional investment projections are correct, the distribution of where that investment falls in relation to each council may not be correct.

Potential Impact of Levels of Service Enhancements and Growth Investment Assumptions

7.26 WICS have used the derived future investment numbers in the stand-alone financial analysis provided to councils as well as in the analysis completed for each water services entity. The higher numbers have a flow on effect to several assumptions, most importantly, the future revenue required by councils. This is then reflected in the calculated household charge.

7.27 ML also note that for the purposes of their modelling WICS have assumed that this investment is evenly spread across the modelling period, however it is likely that this will be weighted further toward future years in practice. This results in a sharp increase in projected future household charges.

7.28 If the future investment requirements are understated or overstated, there is likely to be a consistent impact on both the council and entity household charge projections. While this assumption may change the scale of the difference in projections it is unlikely to change the overall outcome of their analysis.

Revenue

7.29 Projected revenue is ultimately the main input into the WICS model that is used to determine household charges. The way in which future revenue is projected is therefore critical.

Three Water Debt to Revenue Ratio

7.30 The total three waters revenue that is needed to be collected by councils in the WICS model has been determined by reference to each council's total borrowing.

THREE WATERS REPORT UPDATE

7.31 Revenue projections have been calculated by identifying the amount of revenue needed to ensure that each council maintains a three waters debt to revenue ratio below 250% over the entire modelling period. Revenue increases are front-loaded in the WICS model, with revenue increases typically stabilising to match inflation over time (or at least reducing).

7.32 The WICS modelling results in forecast future revenue requirements which typically result in the council generating a significant operating surplus for its three waters activity. This surplus is applied toward debt management/repayment.

7.33 Water services entities appear to not have been subject to this restriction with WSE 'C's debt to revenue ratio reaching almost 800% by 2051. We understand that the Government has received advice to suggest that a debt to revenue ratio of this magnitude would not adversely impact on water services entities' credit ratings.

Comments on Underlying Assumptions for Revenue

7.34 ML notes that councils are not typically financed on an activity basis. That is, councils are not required to maintain a three waters debt to three waters revenue ratio of 250%, and in fact several councils already exceed this ratio when looking only at three waters debt to revenue.

7.35 Three waters typically make up between 20–30% of a council's total revenue, with most other activities typically requiring only low levels of debt. While three waters charges may increase at a much higher rate than other areas of council's business, ML would still anticipate that a three waters debt to revenue ratio of around 500% would be within most council's future borrowing capability.

Potential Impact of Revenue Assumptions

7.36 The revenue numbers directly translate into household charges for councils and the water services entities.

7.37 As councils are likely to be able to borrow more than 250% of their three waters revenue, the projected household charges are likely overstated.

7.38 Because no such cap has been applied to the water services entities, and we understand that there is official advice to support water services entities maintaining large debt to revenue ratios, this assumption has limited bearing on the projected household charges for the water services entity itself.

7.39 When viewed together, the application of this assumption by WICS is likely to overstate the size of the difference in charges between council and the water services entity.

Revenue from Households

7.40 WICS has used the split of revenue between households and non-households of 70% as observed in the UK. This has been applied to the total revenue figure above.

7.41 The 70% figure represents the total amount of three waters revenue derived from household water charges and effectively does not include any revenue from development contributions, grants and subsidies, or commercial and industrial water use (or indeed irrigation/stock water schemes).

Comments on the underlying Assumptions on Revenue from Households

7.42 In ML's view the assumption that 70% of revenue comes from household water charges appears to be fair at a national or water services entity level. However, this assumption is less likely to be applicable at an individual council level, noting that:

- Councils that have high levels of urban growth may receive a substantial portion of water revenue from development contributions, and in some cases, this may account for the entire remaining 30% (or more) on its own.
- Highly rural councils may receive a large proportion of their three waters revenue from irrigation or stock water schemes, meaning much less than 70% of total three waters revenue is derived from households.
- Some territorial authorities receive large amounts of three waters revenue from large water users. This is particularly true in rural and provincial councils, which often have high water users in the agricultural and horticultural industries.

7.43 It should be noted that for the Tasman District the household revenue comprises around 59% of the total revenue.

Potential Impact of Revenue from Household Assumptions

7.44 This assumption may impact on the size of the difference between the projected household charges under the council and entity scenarios because it is likely to be more accurate at an entity level than it may be for individual councils.

7.45 Councils that receive a lower proportion of their three waters revenue from households than is assumed in the WICS analysis, will have higher projected household charges under the WICS analysis than they may otherwise have.

7.46 WICS analysis is also presented at a three waters level, which means it is difficult to see the impact for customers which may only receive one or two of the services provided. This is likely to be particularly relevant for councils with large rural areas.

Household Connections

7.47 WICS have determined the number of household connections in their modelling by:

- Averaging the connected water and wastewater populations from each council's RFI;
- Dividing the number by 2.7 (which is the average household density in New Zealand).

7.48 This value is used as the denominator in WICS' projections of average household charges. The higher this number is, the lower the projected household charge is.

7.49 WICS does not appear to have used any data regarding stormwater connections/charges within its analysis.

Comments on the underlying Assumptions on Household Connections

7.50 Household density varies significantly between territorial authorities within New Zealand. This is particularly prevalent in the comparison of rural and urban councils. According to Statistics New Zealand, in 2018 the council with the highest occupancy rate has an average of 3.0 residents per household, compared to the least dense council having an occupancy rate of 2.1.

7.51 We understand that there are now councils that have significantly lower occupancy rates than that still (with some reporting occupancy rates of less than 2 residents per household).

Potential Impact of Assumption on Household Connections

7.52 This assumption may result in a difference between the projected council and entity values (i.e. it will affect the entity and council differently) because the household density number varies significantly between council areas, but is likely to be more accurate at an entity level.

7.53 For councils with low household density, it is likely that the application of this assumption will have resulted in the WICS analysis overstating the potential household charges in 2051 for individual councils. The projected household charges for the water services entity are less likely to be affected by the application of this assumption.

Capital and Operating Efficiencies

7.54 WICS looks separately at capital and operating efficiency expenditure. In both cases, WICS undertook econometric modelling (using the reworked Ofwat -Water Service Regulation Authority UK, 2004 and 2009 models) of the potential for operating efficiency from each council using tools and techniques applied and fitted to UK water entities and tested this against New Zealand.

Efficiencies

7.55 WICS have applied efficiencies adjustments in some cases for individual councils. These efficiencies have been based on council size. The observed experience from the UK demonstrates that only entities of a scale of more than 60,000 connected citizens could be expected to achieve any reductions in operating costs, even if they were subjected to robust governance and regulatory frameworks.

7.56 In the models provided, the scale efficiencies increase on a diminishing (logarithmic) basis above the minimum size threshold. This means there is no inclusion for efficiency improvement for councils with less than 60,000 population served. For councils above this threshold, efficiency gains are achievable (albeit at a diminishing rate) up to a maximum of 800,000 population served, after which no further returns to scale have been included in WICS modelling.

7.57 In determining the scale of efficiencies modelled for the Water Services Entities, WICS assesses the New Zealand Three Waters sector to be in a broadly similar position as Scotland in 2002, in terms of relative operating efficiency and levels of service. In just under two decades, Scottish Water has lowered its unit costs by 45% and closed the levels of service gap on the best-performing water companies in the United Kingdom.

7.58 WICS considers that New Zealand can achieve similar outcomes to Scottish Water i.e. a reduction of up to 45% over a longer period (30 years).

Comments on the Underlying Assumptions on Efficiencies

7.59 We note that WSE ‘C’ is projected to have around 960,000 customers on formation. This is comparable in size (but much less densely populated) to Bristol Water and South Staffordshire Water, who were cited as achieving efficiencies of 25% and 20% respectively in the WICS reports.

Potential Impact of Assumption on Efficiencies

7.60 If modelled efficiencies from service delivery reform are overestimated or underestimated, then this will have a direct impact on the projected household charges for the water services entities. That is, overestimation of the potential operating efficiencies will result in WICS' projections of household charges for water services entities being lower than they may otherwise be if those efficiency targets are unable to be met.

7.61 I would like to add that unlike the UK and Scotland, New Zealand has been competitively procuring the delivery of three waters for over 20 years. This in itself has implemented fiscal tension and thereby achieved some efficiencies. Although I believe there is opportunity for more efficiencies to be gained, particularly in the management of the three waters, I don't believe it will be to the same extent assumed by WICS. This would also apply to most councils within New Zealand.

Sensitivity

7.62 WICS undertook detailed sensitivity analysis (Monte Carlo analysis) of their projected household charges to demonstrate whether there are any instances where household charges would be lower under continued council led service delivery versus the reform, scenario.

7.63 Across the country, this analysis shows only a very limited number of cases where household charges have any potential to be lower without reform than with it. In these cases, WICS typically notes that the levels of service received by customers without reform would be significantly lower than they would be under the reform scenario.

7.64 Importantly, while this sensitivity analysis does consider different levels of investment requirements, it does not consider the impact of the debt to revenue assumption, or assumptions regarding the percentage of revenue from households, or the number of connections.

7.65 ML has not attempted to recreate the sensitivity analysis completed by WICS but would anticipate that correction of these assumptions prior to undertaking the sensitivity analysis would result in more instances where future household charges crossover under the reform and no reform scenarios.

8 Three Waters Reform versus Fresh Water Improvement

8.1 In preparing itself to decide on the Three Waters reform, it is important that the Council is aware of what the decision is about. The three waters assets proposed to be transferred to the new Crown entity are the water and wastewater and possibly stormwater treatment facilities, lagoons, pipes (water distribution network), pumps and all associated infrastructure that ratepayers and users have invested in over many years. This is not to be confused with the Government's intentions on freshwater or water as a resource in general.

9 Tasman District Council and the Three Waters Reform

9.1 At this stage, the Council's current position on the Three Waters Reform is outlined as follows;

a) The Council has signed a MoU with Government (Department of Internal Affairs) and accepted the initial funding of $9.78 million for water, wastewater and stormwater projects;

b) These projects have been programmed and are being implemented in accordance with the agreed Delivery Plan;

c) The Council has agreed to continue to engage with the DIA in good faith on the three water reforms;

d) The Council participated in the DIA / Water Industry Commission for Scotland (WICS) Request for Information (RFI) process in January 2021;

e) The Council will be subject to Taumata Arowai regulation (replacing the Ministry of Health once the Water Services Bill is enacted);

f) The Council will be subject to provisions of the Water Services Act when it is enacted;

g) The Council still has the option to opt-out of the three waters reform. Any decision to that effect is likely to be made November/December 2021;

h) The Council will have to comply with Taumata Arowai and Water Services Act provisions during the transition period (until 1 July 2024) if joining the new entity, and indefinitely if the Council decides to opt out.

10 Strategy and Risks

10.1 The Government has maintained its messaging that Council’s will have the opportunity to opt-in or opt-out.

10.2 In deciding on whether to opt-in or opt-out, council will need to consider the following risks associated with opting-out of the three waters reform:

a) The ability to meet the new service level and Taumata Arowai regulatory requirements;

b) The ability to resource infrastructure service delivery requirements – staff and external support;

c) The ability to engage effectively with iwi, within the new statutory requirements;

d) Rural water supply challenges;

e) The Economic Regulator will price set water charges; The Council may lose flexibility in this – see Lines Companies as an example;

f) The Environmental Protection Agency may introduce a range of higher environmental related service levels.

10.3 There are also risks with opting in to the reform programme. These risks may arise from centralised management and services delivery verses local management and service delivery. Often, smaller local communities do not attract the same attention as the larger towns and cities. An example is that Tasman District is constantly challenging Waka Kotahi NZTA for funding when we believe that the Council’s priorities are often just as great as those in other areas who seem to attract greater funding. This is subjective and can often only be perception, however centralising services at the expense of local influence is a risk that we must be aware of.

10.4 While it may be argued that some assumptions may overstate the future costs without reform, it is evident that there is still likely to be a significant increase in costs.

10.5 It should also be noted that the Government has launched a wider review of local government. This is a wide ranging review that is being undertaken over the next 2-3 years. Although not directly related to the three waters reform, it will likelyaddress the consequences or impacts of the reform.

11 Options

11.1 At this stage the recommended option is to continue engaging with DIA. As more information is made available, Council can then make a more informed decision at a later date.

11.2 The other option is for Council not to engage any further in the reform process. The consequences being that Council could lose the opportunity of making a more informed decision at a later date. This is not a recommended option at this stage.

12 Policy / Legal Requirements / Plan

12.1 The Long Term Plan 2021/31 does refer to the pending three waters reform and that it could impact on Council's involvement in owning and delivery the three water services. The budgets are based on the three waters remaining within Council for the next 10 years.

12.2 Any legal aspects associated with the three waters are likely to be dealt with in new or amendments to existing government legislation. At this stage there are no legal requirements that need to be considered by Council.

13 Consideration of Financial and Budgetary Implications

13.1 Although the three waters reform will eventually have significant financial and budgetary implications, the government is clear in its latest announcements that council will not be financially disadvantaged with the three waters reform.

13.2 As stated previously the budgets in Council's Long Term Plan 2021-31 are based on the three waters remaining in Council ownership.

14 Significance and Engagement

14.1 The three waters activities are listed as a strategic asset in Council's Significance and Engagement Policy. Therefore, under current legislation, any decision transferring ownership of the three water activities will require statutory processes to be followed including formal public consultation with the community.

14.2 Parliament is sovereign, and this sovereignty allows it to change the law that constitutes and empowers councils. In turn, council is obliged to comply with relevant legislation while it is in force. Therefore, in progressing the three waters reform, the government could modify current legislation or enact new legislation that exempts councils from undertaking public consultation on the transfer of ownership to the new WSEs.

14.3 This report focuses on the Council continuing to engage with DIA in the reform process. We understand that the Council is not required to consult with its communities prior to providing feedback to the government before the end of September 2021. Essentially the Council is being asked to fact-check data that is very technical. It is also providing feedback which will not in itself determine the outcome of the three waters process for the Council. We understand these are not matters that would normally trigger a consultation requirement.

14.4 The reform will be implemented by legislation. The Government has indicated that this process will involve some form of public consultation.

14.5 Given the context of the imminent reform, we understand that any Council decision to 'opt in' or 'opt out', would be a significant decision both in terms of the Local Government Act (LGA) and in the Councils Significance and Engagement Policy. Such a decision would require consultation according to s77 and s78 of the LGA.

	Issue	**Level of Significance**	**Explanation of Assessment**
1.	Is there a high level of public interest, or is decision likely to be controversial?	Low	The Council is only confirming that it will continue engaging with DIA
2.	Are there impacts on the social, economic, environmental or cultural aspects of well-being of the community in the present or future?	Low	No impacts on the well-being of the community.
3.	Is there a significant impact arising from duration of the effects from the decision?	Low	The decision is only to continue engaging with DIA until it is time to decide and that will be the subject of a separate decision.
4.	Does this activity contribute or detract from one of the goals in the Tasman Climate Action Plan 2019?	No	
5.	Does the decision relate to a strategic asset? (refer Significance and Engagement Policy for list of strategic assets)	Yes	Although it relates to strategic assets it does not affect the ownership of delivery of services related to that strategic assets.
6.	Does the decision create a substantial change in the level of service provided by Council?	No	
7.	Does the proposal, activity or decision substantially affect debt, rates or Council finances in any one year or more of the LTP?	No	

THREE WATERS REPORT UPDATE

	Issue	Level of Significance	Explanation of Assessment
8.	Does the decision involve the sale of a substantial proportion or controlling interest in a CCO or CCTO?	No	
9.	Does the proposal or decision involve entry into a private sector partnership or contract to carry out the deliver on any Council group of activities?	No	
10.	Does the proposal or decision involve Council exiting from or entering into a group of activities?	No	
11.	Does the proposal require inclusion of Māori in the decision making process (consistent with s81 of the LGA)?	No	

15 Conclusion

15.1 The three waters reform programme is underway. In July 2021 councils received the outcomes of the assessments and analysis undertaken by WICS. Although there are some questions around the scale of the increased costs, it is clear that whether councils opt-in or opt-out there will be increased costs for the three water services.

15.2 The WICS assumptions have been clearly outlined in this report. The direct impacts of these assumptions on the Council will be the subject of a second report in late September so that it can provide better informed feedback to DIA.

15.3 This report is about continuing to engage with DIA to obtain as much information as possible to better inform the Council. A decision to ‘opt-in’ or ‘opt-out’ of the three waters reform programme will need to be made at a future date.

15.4 There is no need to specifically consult with the community in making the decision to keep engaging with DIA.

16 Next Steps / Timeline

16.1 The next steps are to continue to engage with DIA and gather as much information as possible on the three waters reform programme.

16.2 In the meantime, staff will assess the implications of the three waters reform in more detail and report back to the Council in late September 2021.

16.3 Once DIA has assessed the feedback, we suspect it will provide further information or decisions on how and when the Council needs to decide whether to ‘opt-in’ or ‘opt-out’.

Attachments

THREE WATERS REPORT UPDATE

1. Three Waters Reform Programme - Water Service Entities
2. Morrison Low Report - Review of WICS Data