BUDDLE FINDLAY

Three waters reform and investment thrown a lifeline

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Before the COVID-19 crisis, a significant amount of infrastructure and construction reform was underway, including in relation to the management and funding of drinking water, stormwater and waste water (Three waters). However, the stimulus response to COVID-19 has the potential for a generational shift in three waters infrastructure investment. On 8 July, the Government announced that it would provide $761m to assist local government to upgrade three waters infrastructure, from the more than $5b of infrastructure investment allocated to help kick-start the post-covid economy. While a lot of money, it is a drop in the bucket of the total cost for fit-for-purpose three waters infrastructure in New Zealand.

It is well known that three waters infrastructure requires significant investment. Funding the delivery of three waters has been challenging for local authorities due to growth pressures, limited resources, historic under or deferred investment, resilience issues and ever-increasing health and environmental standards.

Rebuilding our economy provides a significant opportunity for local authorities to get Government support for overdue projects. But such support is not a free lunch. The Government is clear that it wants projects delivered quickly and, critically, that funding is conditional on local authorities opting into the Government's wider water reform programme.

Previously, the Government raised the prospect of forcing aggregation. While such an approach has not been adopted, only those councils who agree to the first tranche of the reform programme (expected to require councils to share detailed data about their three waters infrastructure) are eligible for the $761m funding. Once more detailed policy work has been completed, it is expected that councils will need to decide whether to then participate in the second and third tranches of the reform programme (and if they do participate it will be binding on them).

The Government's clear view is that current service delivery arrangements are not fit-for-purpose, particularly for the smaller councils. The Government wants aggregation (of assets and services) within the sector to provide scale in the form of public multi-regional water entities and take account of catchment-related and communities-of-interest considerations (which become harder the bigger the area covered). However, the final shape (and scale) of such entities are still to be determined.

Presently in New Zealand, limited rationalisation has occurred in the sector. Notable examples include the partnering between Watercare Services Limited (owned by Auckland Council) and Waikato District Council for service delivery, and Wellington Water (aggregation of operations and service delivery).

While there are obvious economies of scale benefits in planning, expertise, delivery and governance with such models it is critical that funding, asset ownership and service delivery are all combined. If service delivery is amalgamated but funding is retained by individual councils, then funding issues will continue as the decision-makers face pressure to spend elsewhere (or to not increase rates). Minister Jones has already suggested that Watercare Services Limited could look to provide water and wastewater to Northland (due to proximity but also because it has a good balance sheet).

Minister Jones' reasons show why rationalisation or aggregation of assets and services needs to be assessed on a case by case basis. Some councils have planned and invested better than others in three waters infrastructure and their communities have already paid, or are paying, for it. Should councils that have not invested as wisely potentially get a free lunch through forced aggregation? However, affordability varies dramatically between communities, and some social cost distribution may be appropriate (and may align with Government intentions). Different communities also have different aspirations. For example, despite well documented drinking water issues some communities do not want chlorination.

Whilst the budget allocation for funding water infrastructure is certainly welcome, there is no detail about how this funding will be provided to councils. Many councils are struggling with debt levels that are close to their maximum limits. A loan from the Crown will still be debt on council balance sheets, albeit on potentially more favourable terms than commercial borrowing.

There is also a question about how the proposed investment by the Crown will fit with other funding regimes such as that proposed by the Infrastructure Funding and Financing Bill (which is currently awaiting its second reading). The Bill proposes a mechanism for councils to ring-fence infrastructure projects by enabling a special purpose vehicle (SPV) to be set up to raise finance and construct such projects, so that the debt associated with them does not appear on the council's books. The councils can then raise a multi-year levy, to be paid by the beneficiaries of the infrastructure, to repay project debt. However, the Bill also prevents councils from providing any loan or other financial support to the SPV. This could mean that if this structure is used, the Crown may need to fund the SPV directly. The most effective financing solution for each council will be different and there will need to be close examination of the options available to each council when making an investment decision.

Significant structural change will happen in the next few years across the sector. But the Government now wants more than that - it wants investment and, critically, development, to occur fast to help support the economic recovery while providing improved public health and environmental outcomes. The new funding is tied to both speeding up the reforms and delivering funding to support local authorities. But not all local authorities are looking to invest in the current COVID-19 environment. There is significant pressure to have little, if any, rate rises. That places added pressure on the Government in driving meaningful change both in processes and in delivery of projects.

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