Simpson Grierson

Infrastructure: review, reform and recover

September 2020

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Our wish list
for the new government

Invest now – Maximise the impact of the stimulus by enlarging the Covid-19 Response and Recovery Fund and extending the timeframe of the Covid-19 Recovery (Fast-Track Consenting) Act 2020.

Offer direction – Provide a special legislative case for major infrastructure within planning frameworks. Articulate when and how infrastructure may be provided for in more sensitive environments through national direction.

Act with urgency – Progress RMA reform as a priority, but acknowledge that new legislation will not be a silver-bullet. Through informed, non-partisan, debate we must recognise the importance of environmental resilience, and be willing to pay for climate-friendly outcomes.

Test new tools – Road-test the Infrastructure Levy Model on greenfields housing projects, but work on its application to more challenging brownfields projects where it may provide the most utility.

Build resilience – Promote a fair, efficient and equitable contracting environment that will provide greater resilience in the contracting sector.

Entrust Te Waihanga – Provide Te Waihanga with the time and licence needed to influence our approach to infrastructure procurement using independent, evidence-based analysis – to help create a stable and consistent procurement environment free, as far as possible, from political whim.

Be bold – Continue to explore new channels to fund the infrastructure deficit – learning from value capture techniques used abroad.

Be resourceful – Review revenue policy settings to ensure we are optimising the potential for private investment to help bridge the infrastructure deficit.

Embrace Opportunity – Don’t miss the Three Waters opportunity – engage meaningfully to identify a solution that will deliver the benefits of aggregation while recognising the New Zealand context and the benefits of local representation.

Think ahead – Further develop industry guidance on contract amendments – addressing Covid-19 issues and reflecting Construction Sector Accord principles.

This paper reviews the initiatives progressed by the Government in its three year term, and offers our thoughts on what further reform is needed in the current environment to support New Zealand's recovery – both from the economic impact of Covid-19 and the country's long-standing infrastructure deficit.

Introduction

New Zealand's infrastructure dilemma continues to be one of the most significant issues facing the country today.

Infrastructure supports much of our daily lives – it provides the water we drink, the roads and rail we travel on, and the local services we depend upon.

It provides the bedrock on which our economy is built. Yet decades of under-investment and inconsistent policy at central and local government levels, combined with significant population growth in recent years, has left New Zealand with a significant infrastructure deficit that must now be addressed in order to maintain our quality of life and economic competitiveness at a global level.

Our problems have been well traversed. They include legislation that is poorly integrated and not designed to deliver outcomes that support a growing population, constraints on the workable funding and financing options, institutions that lack critical mass and which are not appropriately incentivised to deliver outcomes that benefit regions and New Zealand as a whole, and a construction sector under pressure.

These problems have manifested in a lack of affordable housing, inefficient transport networks in our largest cities and environmental degradation.

Fortunately, the current Government has recognised the urgency of the situation and given considerable attention to resolving these issues – including under its centrepiece infrastructure policy framework – the Urban Growth Agenda (UGA). The UGA aims to remove barriers to the supply of infrastructure and make room for our cities to grow up and out.

Several initiatives are now at various stages of development to address the five pillars of the UGA – infrastructure funding and financing, urban planning, spatial planning, transport pricing, and legislative reform.

While the Covid-19 pandemic has severely interrupted life as we know it in New Zealand and rightly diverted attention to more pressing and urgent matters in the short term, the aftermath of the health crisis also presents an opportunity.

With our country faring better than many others around the globe, both in terms of public health and economic activity, we can shift our focus to the future and allow government and business to build towards a better New Zealand – this time with accelerated infrastructure reform and investment as a cornerstone of the recovery.

Infrastructure reform in perspective

Major infrastructure delivery depends on a sound supporting regulatory and policy framework across a range of disciplines.

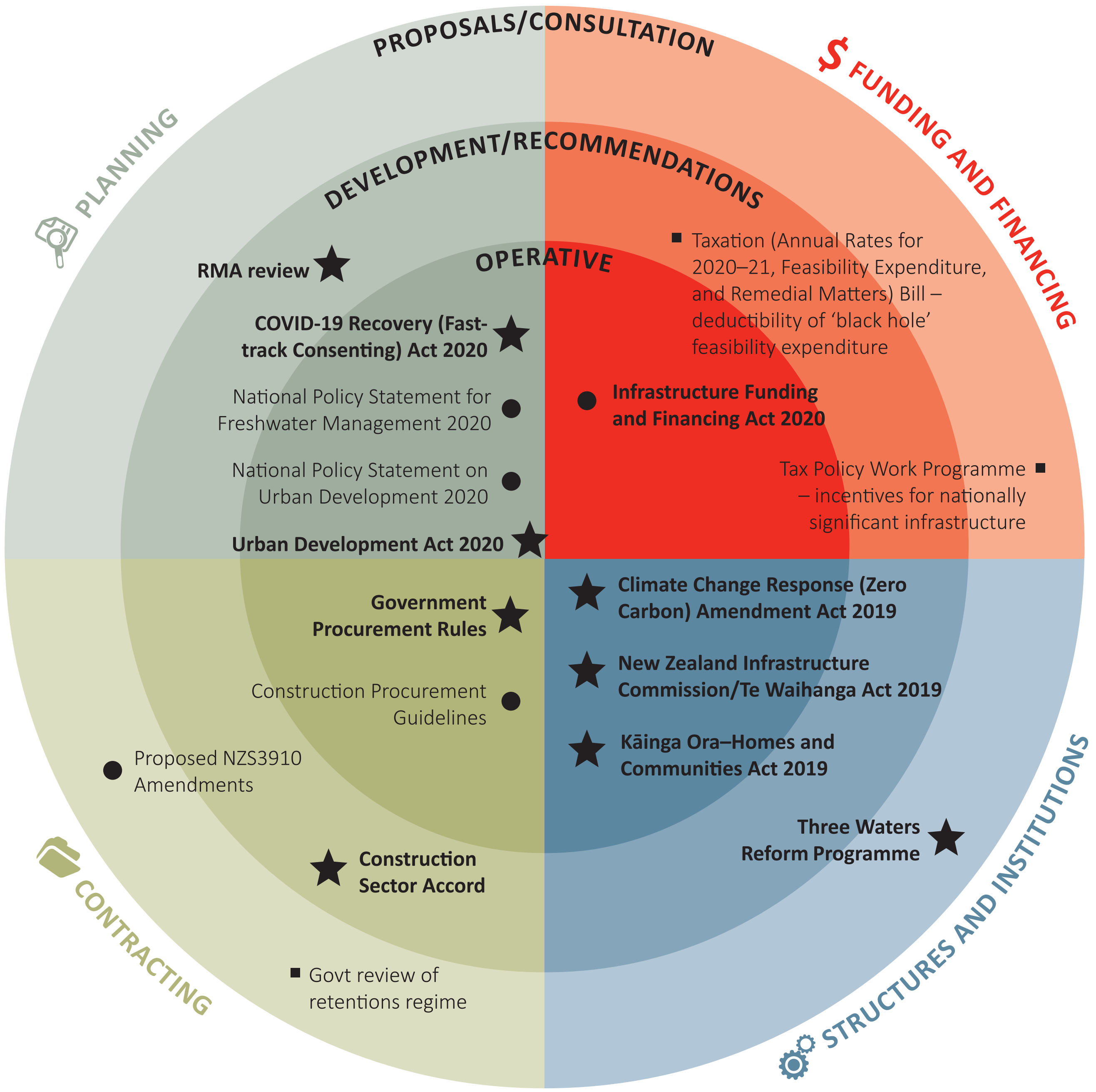
The key areas include **planning and consenting**, **funding and financing**, and **contracting** – but strong frameworks in those disciplines will not yield benefits unless the right **structures and institutions** are in place to navigate them.

Over the past three years, in addition to major policy announcements such as the New Zealand Upgrade Programme and Covid-19 Response and Recovery Fund, the Government has made significant headway in improving the regulatory framework that underpins infrastructure delivery. Our Regulatory Radar diagram (next page) locates each item of reform activity based on its progression, impact, and area(s) affected.

While much work remains to be done, the radar shows the extent, and relevance, of recent reforms. In the following pages we explore the issues, reform measures, and work yet to be done in each area.

REGULATORY RADAR: INFRASTRUCTURE DELIVERY REFORM

The Regulatory Radar locates reform activity from the past three years that will have an appreciable impact on infrastructure delivery, based on progression, impact and area(s) affected.



KEY: LIKELY IMPACT OF REFORM ★ **High Impact** ● Medium Impact ■ Low Impact

Delivering infrastructure: Planning

SNAPSHOT OF CHALLENGES

While our national population and urban centres are rapidly growing, the provision of development capacity and infrastructure necessary to keep up with growth is lagging.

This deficit has coincided with a time when the natural environment is under significant pressure from the effects of climate change, threats to biodiversity and wider environmental decline – resulting in environmental bottom lines becoming increasingly more stringent and difficult to meet.

In this setting, an efficient and effective planning framework that is able to cope with those competing tensions in a timely and cost-effective way is critical. Yet timeframes and costs for consenting within the Resource Management Act 1991 (**RMA**) framework have presented a challenge to the development of much needed infrastructure for some time.

Covid-19 has highlighted the potential challenges in getting necessary planning approvals fast enough to enable prompt commencement of work, and intensified the progress towards streamlining RMA processes.

SUMMARY OF REFORM TO DATE

New processes and powers recently introduced (and under development) may go some way to resolving the planning challenges facing infrastructure development in New Zealand.

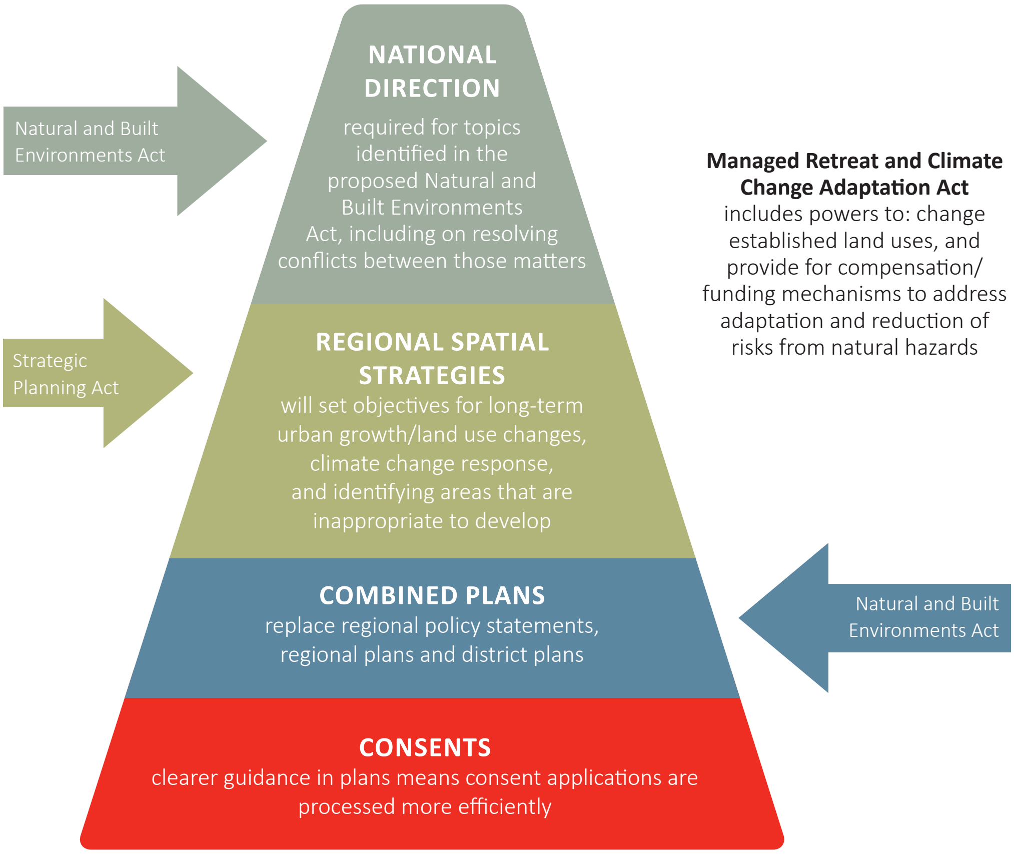
Recent reforms have included the streamlining of RMA processes and the introduction of new powers via the COVID-19 Recovery (Fast-track Consenting) Act 2020 (**Fast-track Act**) and the Urban Development Act 2020 (**UDA**).

The Resource Management Amendment Act 2020 has also made some changes to the RMA, with far more substantial RMA reform a high likelihood in the near future following the review of the resource management system.

RMA reform

In July, the Resource Management Review Panel released its report and recommendations on RMA reform. Its recommendations included repealing the RMA and replacing it with three new Acts: the Natural and Built Environments Act, the Strategic Planning Act and the Managed Retreat and Climate Change Adaptation Act (see diagram).

PROPOSED NEW PLANNING AND CONSENTING FRAMEWORK



The recommendations have been welcomed by the Government and opposition parties alike, meaning major legislative change in the next parliamentary term is highly likely. This will have very significant, permanent impacts on infrastructure development. For instance, the proposed Strategic Planning Act should reduce costs and increase the efficiency of land use and infrastructure planning, processes and funding, and would align multiple Acts (Local Government Act, Land Transport Management Act, Climate Change Response Act and the proposed Natural and Built Environments Act).

COVID-19 Recovery (Fast-track Consenting) Act 2020

The Fast-track Consenting Act has introduced an alternative, truncated consenting process for projects that can demonstrate they will provide an immediate boost to employment and economic recovery. It is the key tool required to facilitate an infrastructure-led recovery, with large-scale infrastructure projects obvious candidates for the fast-track consenting process.

Fast-track consenting is intended to get projects started, and people into jobs, faster than would otherwise happen under standard RMA consenting and approval processes. The 17 projects initially identified were included on the basis that they were "*shovel ready*" and only reliant on RMA approvals before construction could commence.

However, given the long lead times that are generally required for infrastructure projects, we anticipate that only a subset of the anticipated projects will currently be able to take advantage of the fast-track consenting before the legislation self-repeals on 8 July 2022.

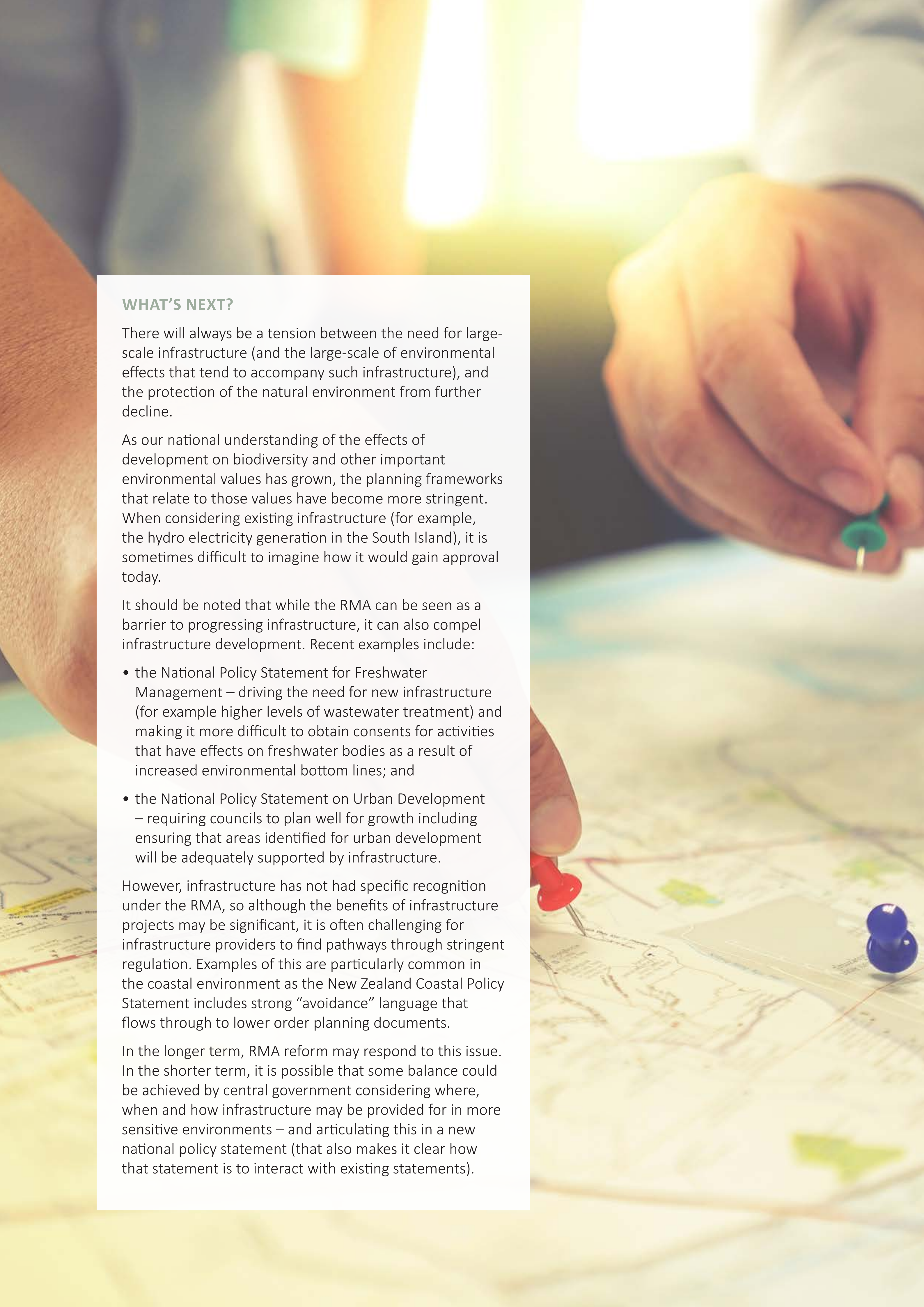
While other streamlining options are available for infrastructure projects under the RMA, namely using the Board of Inquiry process or direct referral to the Environment Court, the fast-track consenting process is the most truncated now available.

Kāinga Ora

There have also been significant changes to the processes for major urban development projects through the creation of Kāinga Ora (the Crown agency tasked with implementing the Government's housing and urban development agenda).

Kāinga Ora's well-publicised streamlined approval powers for urban development projects under the UDA are significant and will undoubtedly be used to speed up the delivery of major projects. However, they are likely to do little to address the broader time and cost issues with infrastructure or the RMA consenting process because:

- the powers will only apply to Kāinga Ora's projects (which are predominantly urban development projects) and will therefore be spatially limited; and
- Kāinga Ora will, we expect, work collaboratively with private developers, iwi, and councils. So, although the UDA goes some way to streamlining the consenting process, there will still be many interests to take into account (perhaps no fewer than would arise through an RMA process).



WHAT'S NEXT?

There will always be a tension between the need for large-scale infrastructure (and the large-scale of environmental effects that tend to accompany such infrastructure), and the protection of the natural environment from further decline.

As our national understanding of the effects of development on biodiversity and other important environmental values has grown, the planning frameworks that relate to those values have become more stringent. When considering existing infrastructure (for example, the hydro electricity generation in the South Island), it is sometimes difficult to imagine how it would gain approval today.

It should be noted that while the RMA can be seen as a barrier to progressing infrastructure, it can also compel infrastructure development. Recent examples include:

- the National Policy Statement for Freshwater Management – driving the need for new infrastructure (for example higher levels of wastewater treatment) and making it more difficult to obtain consents for activities that have effects on freshwater bodies as a result of increased environmental bottom lines; and
- the National Policy Statement on Urban Development – requiring councils to plan well for growth including ensuring that areas identified for urban development will be adequately supported by infrastructure.

However, infrastructure has not had specific recognition under the RMA, so although the benefits of infrastructure projects may be significant, it is often challenging for infrastructure providers to find pathways through stringent regulation. Examples of this are particularly common in the coastal environment as the New Zealand Coastal Policy Statement includes strong "avoidance" language that flows through to lower order planning documents.

In the longer term, RMA reform may respond to this issue. In the shorter term, it is possible that some balance could be achieved by central government considering where, when and how infrastructure may be provided for in more sensitive environments – and articulating this in a new national policy statement (that also makes it clear how that statement is to interact with existing statements).

$ Delivering infrastructure: Funding and Financing

SNAPSHOT OF CHALLENGES

2020 has seen a meteoric rise in funding committed to infrastructure – initially through the $12 billion New Zealand Upgrade Programme and, more recently, through the $3 billion ('shovel-ready') Covid-19 Response and Recovery Fund, and $761 million water upgrade package.

The commitment to substantially increase funding available for critical infrastructure projects is welcome news to those that will directly benefit from particular projects, as well as others in the wider economy who will see the indirect benefits of infrastructure-led economic stimulation.

However, that stimulation will be a short term measure.

In the longer term, our infrastructure deficit will only be addressed if all stakeholders have the necessary tools to ensure that fit-for-purpose funding and financing solutions are available for viable projects.

In New Zealand, key amongst those stakeholders is local government, which manages in excess of $120 billion of assets – including most water and transport infrastructure. Yet, as has been well publicised, local government continues to face major constraints on its ability to both fund and finance the new and replacement infrastructure for which it is responsible.

SUMMARY OF REFORM TO DATE

Housing Infrastructure Fund

Local authorities across the country are constrained by debt ceilings that limit capacity for debt to finance viable projects that are desperately needed to support growth and replace aging assets.

The Housing Infrastructure Fund (**HIF**) – a one-off contestable $1 billion fund that provided 10-year interest-free loans to high-growth councils to finance core infrastructure – was originally conceived of as a solution to this problem. However, while laudable in its intent, the on-balance sheet HIF debt needs to be included in local authority debt covenants and so does little to address financial constraints.

Infrastructure Funding and Financing Programme

Consequently, the Government sought, through its Infrastructure Funding and Financing Programme – a key part of the Urban Growth Agenda – to add to the tools and mechanisms local authorities and others have to fund and finance infrastructure.

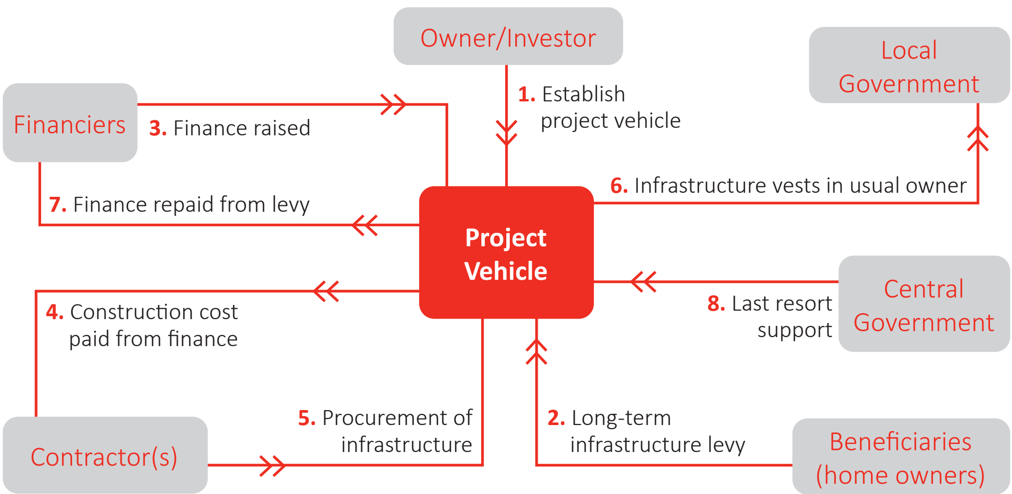
Its flagship legislation, the Infrastructure Funding and Financing Act 2020 (**IFF Act**), is expected to provide an off-balance sheet solution for the funding and financing of local infrastructure.

The solution, known as the Infrastructure Levy Model, sidesteps existing financial constraints faced by many high-growth local authorities by providing for a project company to be able to collect a multi-year levy (with the approval of the Crown and relevant local authority) from the beneficiaries of infrastructure and raise debt on the strength of the levy cashflow.

Key features of the Infrastructure Levy Model

- **off-balance sheet:** the project company will carry the debt burden, thereby unshackling the project from the relevant local authority's debt constraints
- **ownership:** the IFF Act does not include any regulatory restriction on the ownership of the project company, making private investment a possibility
- **infrastructure assets:** the assets procured through the model must nevertheless be maintained in public ownership, by way of vesting in the relevant public authority upon completion
- **intergenerational equity:** the model preserves the traditional use of long-term debt finance as a means of spreading the cost of infrastructure in accordance with the principle of intergenerational equity
- **growth-pays-for-growth:** in directing the levy to the beneficiaries of the infrastructure, the model provides for those who benefit from the infrastructure to pay for it.

HOW THE INFRASTRUCTURE LEVY MODEL OPERATES



Kāinga Ora and the Urban Development Act

Separately, the UDA Act has provided Kāinga Ora with another avenue for the funding and financing of urban infrastructure projects. While the UDA Act was principally designed as a tool to streamline and consolidate regulatory processes for selected urban development projects, Part 4 of the UDA Act also provides Kāinga Ora with a range of funding powers including rating and development contribution powers in parallel with territorial authorities.

Common among these tools is the creation of statutorily-created revenue streams for new entities that will allow them to attract finance for infrastructure procurement.

They also provide for infrastructure to be procured on a special purpose and a project-by-project basis, providing greater transparency as to the costs of infrastructure procurement and thereby contributing to a more informed cost/benefit debate.

Three Waters reform programme

The Three Waters reform programme will consider optimal arrangements for water service delivery for the next generation of New Zealanders, but it seems clear at the outset that appreciable funding and financing benefits, at least, would accrue from aggregation within the sector.

The creation of new, asset-owning, entities that are remote from local authority balance sheets is expected to support improved access to capital (not constrained by local authority debt ceilings) that could finance the current gap and, in turn, free up local authority balance sheets for other purposes. (See pages 24-27 for more detail on the issues and opportunities.)

Tax incentives unlikely

Tax incentives for investment in infrastructure remain a distant prospect, despite the Treasury and IRD being tasked with considering whether the tax system should have a role in driving infrastructure last year as part of the Government's 18 month tax policy work programme.

The Treasury and IRD's mandate followed a Tax Working Group recommendation after it was urged by the New Zealand Superannuation Fund (**NZSF**) to recommend tax incentives be used to encourage investment in nationally significant infrastructure projects, including a reduced corporate tax rate for certain infrastructure investors.

The Treasury and IRD have now proposed that the current tax rules for infrastructure investment be reviewed to determine whether they "create any significant impediments", with a statement that this would include consideration of the NZSF proposal. However, they went on to lay their cards face-up, stating that "officials' starting point for this workstream is that there should be a high bar before diverging from the broad-base, low rate tax framework".

Initial indications suggested Ministers would be briefed by the end of 2019 on "findings of engagement" by industry stakeholders. However, to date no report has been released. Officials' obvious lack of enthusiasm, not to mention the subsequent onset of the pandemic and ensuing fiscal constraints, suggest there is unlikely to be serious progress on tax incentives in the foreseeable future.

WHAT'S NEXT?

The measures taken by the Government to date go some way to unshackling infrastructure investment from the existing debt constraints of public authorities, and provide an avenue for private finance to help close the infrastructure funding gap.

While the use of private finance for municipal projects can be contentious, there are steps that can be taken to ensure investment is a financing solution only, and does not diminish public ownership and control of assets.

Employ receivables financing techniques to ensure that private investment is backed by (high-quality) public revenue streams only – not public assets

Provide for central and local government control over the tools, without privatisation by stealth

Regulate returns on finance where appropriate – to avoid exploitation of public projects for private gain.

The legislation enacted by the current Government, in particular the IFF Act and the UDA, utilises those measures and represent a step forward for New Zealand's infrastructure funding and financing toolkit. However, greater reform is possible:

- **Expansion to other agencies and projects:** the Infrastructure Levy Model was initially conceived of as financing tool for debt-constrained local authorities and is expected to be used (at least initially) for bulk infrastructure to support greenfields housing development. However, the IFF Act has been prepared on a flexible and permissive basis such that the model could be adapted for brownfields projects and/or by other public agencies – eg those that are responsible for transport infrastructure – providing avenues for finance to support a wider range of infrastructure delivery.
- **Value capture:** regardless of what entity raises debt for infrastructure investment, someone must still pay for it. Finding new funding sources, and ways to fairly share the funding burden, therefore remains critical. Value capture techniques could, with minor regulatory reform, be deployed in New Zealand to unlock further funding sources in an equitable manner to support greater investment in infrastructure.

Delivering infrastructure: Contracting

SNAPSHOT OF CHALLENGES

Prior to Covid-19, both government and industry actors had recognised several challenges in contracting for the delivery of major projects and infrastructure in New Zealand – including:

- inconsistent and uncoordinated construction pipeline planning
- skills and labour shortages
- unclear regulations
- a lack of coordinated leadership
- an uncertain pipeline of work
- use of increasingly extensive special conditions by principals
- construction company collapses.

Covid-19 has created additional challenges, in particular, amplifying the existing skills and labour shortage and also the uncertainty around project funding and delivery.

SUMMARY OF REFORM TO DATE

A major focus of recent reforms is the creation of schemes to identify and implement reform, notably the Construction Sector Accord (**Accord**) and the Infrastructure Commission. MBIE has also played an increasingly significant role in construction and procurement policy development.

Construction Sector Accord

The Accord provides a platform for industry and government to work together on key challenges facing the sector. Most importantly, the Accord launched the three-year Construction Sector Transformation Plan in January 2020. Actions in the plan are focused on change in six areas: Leadership, Business Performance, People Development, Health, Safety and Wellbeing, Regulatory Environment and Procurement and Risk.

Procurement Rules and Guidelines

MBIE has played its part with the release of new Government Procurement Rules (4th edition) and a set of Construction Procurement Guidelines designed to improve the quality and consistency of procurement by government agencies.

Retentions regime

The retentions regime, requiring retention money to be held on trust, was introduced in 2017 to support the robustness of New Zealand's contracting sector. The Government has now proposed changes to the regime to ensure it is fit-for-purpose as the construction sector continues to show signs of distress:

- a new offence and penalties for non-compliant company directors and firms
- strengthening how retention money is held to prevent firms from using it as working capital
- requiring a transparency statement stating where and how much retention money is held

WHAT'S NEXT?

The most immediate contracting challenge will be to address the continuing impact of Covid-19. MBIE and the Accord have published guidance notes in response to key contractual issues arising under NZS 3910 from the initial lockdown, including whether the lockdown necessitated suspension by the Engineer, application of change in law provisions and approaches for public sector agencies to value Covid-19 related variations.

However, the impact of Covid-19 on infrastructure delivery will continue for the immediate future. Parties are likely to adopt increasingly divergent contractual approaches to address the cost and time impacts of future lockdowns or work restrictions. Common industry guidance on amendments to deal with these issues going forward would mitigate the risk of fragmentation in the industry response to Covid-19 and a corresponding increase in claims and disputes.

In addition, infrastructure projects risk being delayed while supply chain issues limit the availability of specialist equipment and materials, and border restrictions prevent specialised labour resources from overseas from entering the country. Further consideration of these impacts by industry participants will be particularly relevant to larger infrastructure projects requiring specialist equipment and workforces for particular activities, such as tunnelling.

Beyond specific contracting amendments to address Covid-19, reforms to deliver a more efficient and equitable contracting model would help to facilitate successful delivery of the infrastructure pipeline. In that regard, an industry-led set of proposed changes to NZS3910/NZS3916 as a driver for contracting reform would be a welcome first step.

Delivering infrastructure: Structures and Institutions

SNAPSHOT OF CHALLENGES

Much has been made of New Zealand's fragmented approach to procurement, inefficient division of infrastructure responsibilities between public sector agencies (particularly as between central and local government) and lack of centralised, strategic planning for nationally significant infrastructure.

Much work has been done to analyse New Zealand's institutional frameworks for infrastructure delivery and consider best practice abroad.

While reform initiatives are underway to address the planning, funding and financing, and contracting issues that constrain our ability to deliver transformative infrastructure, meaningful advancements are unlikely to occur in the absence of appropriate structures and institutions that can promote, implement and guide those reforms.

SUMMARY OF REFORM TO DATE

The Government has sought to deal with these issues by putting in place a framework of dedicated institutions and supporting legislation.

Infrastructure Commission

By far the most significant step in this regard is the creation of the New Zealand Infrastructure Commission/Te Waihanga. Te Waihanga's key roles are to produce a 30-year infrastructure strategy and support central and local government entities to procure and deliver major infrastructure projects, with the intention to support more strategic infrastructure planning and delivery.

Te Waihanga has indicated it will deliver its draft 30 year strategy in late 2021, which will, amongst other things, identify priorities and barriers to good outcomes. The intention is that this plan will replace the government's existing 30 year plan, last produced in 2015, and provide decision makers with a basis for bold reform and policy change, informed by independent, evidence-based analysis.

In the meantime, Te Waihanga also maintains and makes available an infrastructure pipeline of projects, to facilitate future planning and co-ordination across the wider industry.

New Institutions

Other new institutions and bodies have been established, including:

- Kāinga Ora – Homes and Communities: this new Crown agency brings together the functions of Housing New Zealand and its development subsidiary HLC, together with responsibility for leading urban development projects in partnership with Māori, local and central government, and others with the support of the UDA Act. Its creation should provide critical mass and a single focus point for the Government's urban growth aspirations.
- Infrastructure Industry Reference Group (**IIRG**): the establishment of the IIRG, in April 2020, is a direct response to the early stages of Covid-19. Tasked with identifying and help to co-ordinate 'shovel-ready' projects across New Zealand, the relevance of the IIRG may be short-lived, but will nevertheless play a key role in the Government's infrastructure-led recovery plans.
- Three Waters Review: in the wake of the Government inquiry into Havelock North's drinking water and in the face of continued investment constraints, the Government has announced its intention to undertake a far-reaching review of water services delivery over a three year time horizon. Details of the proposed reforms are to be worked through by the Government with participating local authorities, but the Government has indicated a preference for multi-regional models, under local authority ownership, that will be:
  - of significant scale, to enable benefits from aggregation
  - asset-owing entities separated from local government, to support improved access to capital
  - statutory entities with commercial disciplines and competency-based boards.

WHAT'S NEXT?

The Government has made good progress to date in putting in place more suitable institutions and structures to facilitate much needed infrastructure delivery, as well as one-off initiatives in response to Covid-19.

We expect that the composition of the new government after the 2020 election will affect some of the points of emphasis in the new measures, but, with all major parties supporting investment in infrastructure projects as a key part of the Covid-19 recovery, the overall thrust will remain.

In the short term, the work done by Te Waihanga on a new 30 year strategy, and in particular its ability to guide investment to the right projects (as free from political interference as possible) that deliver long-term economic, social and environmental benefits to New Zealand, will be a critical first step.

With the advent of Covid-19 there is a risk that the long term strategy put forward by Te Waihanga may not be consistent with the Government's desire to create employment opportunities and stimulate economic activity in the short term. However, resolving New Zealand's long-standing infrastructure deficit will require institutions to take a long term view and it is therefore critical that Te Waihanga's work is not side-tracked by the challenges in the short term. Other frameworks, such as the IIRG, are poised to focus on nearer term requirements.

Over the longer term, the Three Waters Reform Programme is poised to deliver perhaps the most significant structural reform to the infrastructure and local government sectors since the 1989 local government reforms – creating new public water agencies and freeing up local government to focus on the 'four wellbeings'.

There will undoubtedly be competing tensions and priorities to work through, and a one-size-fits-all model may not work for all communities. But, with proper problem-framing, and meaningful engagement and collaboration, an outcome that both meets the needs of our communities and positions the country to address our long-standing infrastructure deficit is there for the taking.

"We expect that the composition of the new government after the 2020 election will likely affect some of the points of emphasis in the new measures, but, with all major parties supporting investment in infrastructure projects as a key part of the Covid-19 recovery response, the overall thrust will remain."

Spotlight on Three Waters

SNAPSHOT OF CHALLENGES

A sector review following the Government inquiry into Havelock North's drinking water revealed shortcomings in New Zealand's Three Waters infrastructure (drinking, waste and storm water). The exact scale of the problem remains unclear as, in some communities, drinking and wastewater assets remain ungraded, and uncertainty exists as to our stormwater system's resilience to climate change. However, it is clear that significant investment is required.

Being largely owned and operated by local authorities and their council-controlled organisations, the burden of managing and maintaining Three Waters infrastructure has largely fallen on local authorities – some of whom may struggle without support to respond given the sheer scale of investment required.

The challenges facing the Three Waters sector are said to be systemic, from "source to tap, and back again". They vary across communities, but have been framed in the following way by the Department of Internal Affairs:

- **Funding and financing:** Many local authorities, particularly smaller ones, will be unable to fund the infrastructure upgrades required to meet safety standards, keep pace with population growth (or decline), and build resilience against natural events.
- **Capacity and capability:** The attraction and retention of special technical skills necessary to run complex water infrastructure and manage assets is another challenge, again particularly for smaller local authorities.
- **Regulation:** The regulatory environment is weak. Broadly speaking, there are issues with inadequate stewardship, compliance, monitoring and enforcement practices across the Three Waters, and no formal economic regulation to measure service performance.

The challenges will have been exacerbated by Covid-19 and resulting forecasted revenue decreases. Climate change is another factor, making droughts more likely and putting pressure on existing assets.

REFORM ON THE HORIZON

To address these challenges, central government has committed to system-wide reforms to water service delivery arrangements under the recently announced Three Waters Reform Programme. The programme is intended to involve collaboration between central and local government to provide for a fit-for-purpose model and, at the same time, introduce investment stimulus to support New Zealand's Covid-19 recovery.

In July 2020, the Government announced a funding package of $761 million earmarked for local authorities, conditional on authorities participating in the reform process. An additional two tranches of investment will be announced at later strategic dates. The first tranche of funding will support local authorities to maintain planned but unfunded investment and asset quality, with the further tranches expected to, among other things, support large scale asset replacements.

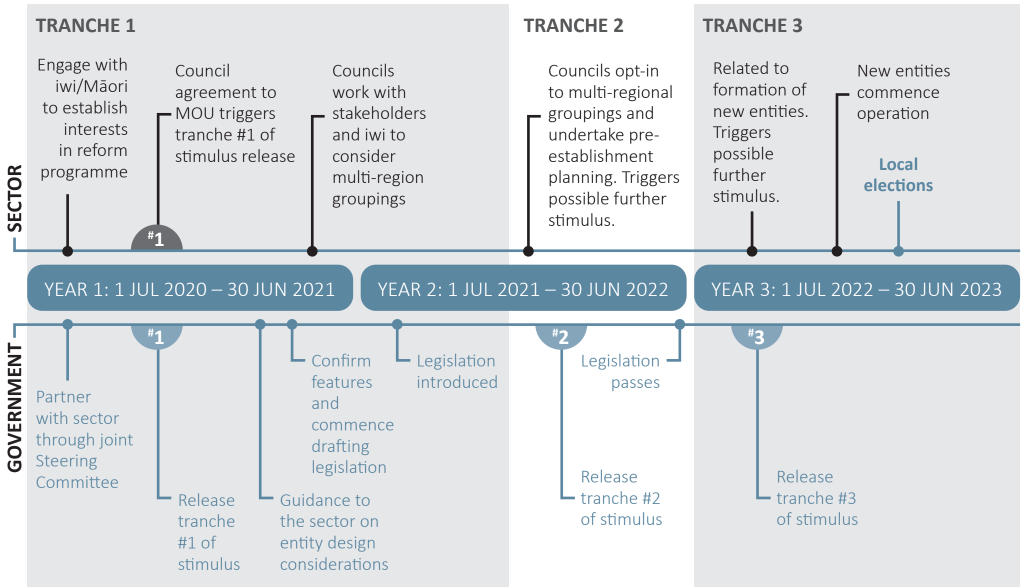
At a high level, the reforms propose the creation of multi-regional, asset-owning water service providers jointly owned by grouped local authorities. Larger scale providers, it is hoped, will benefit from stronger balance sheets, an ability to raise more funding, economies of scale, more technical expertise and the ability to co-ordinate approaches within catchment areas.

On the regulatory side, a new Water Services Bill is, at the date of publication, making its way through the Parliamentary process. This Bill comprehensively reforms the drinking water regulatory system and proposes new national-level reporting and monitoring functions for wastewater and storm water.

A related measure, the Taumata Arowai – the Water Services Regulator Act, establishes a new water regulator (Taumata Arowai). This body will oversee, administer and enforce the new drinking water regulatory system, while also improving the environmental performance of wastewater and stormwater networks.

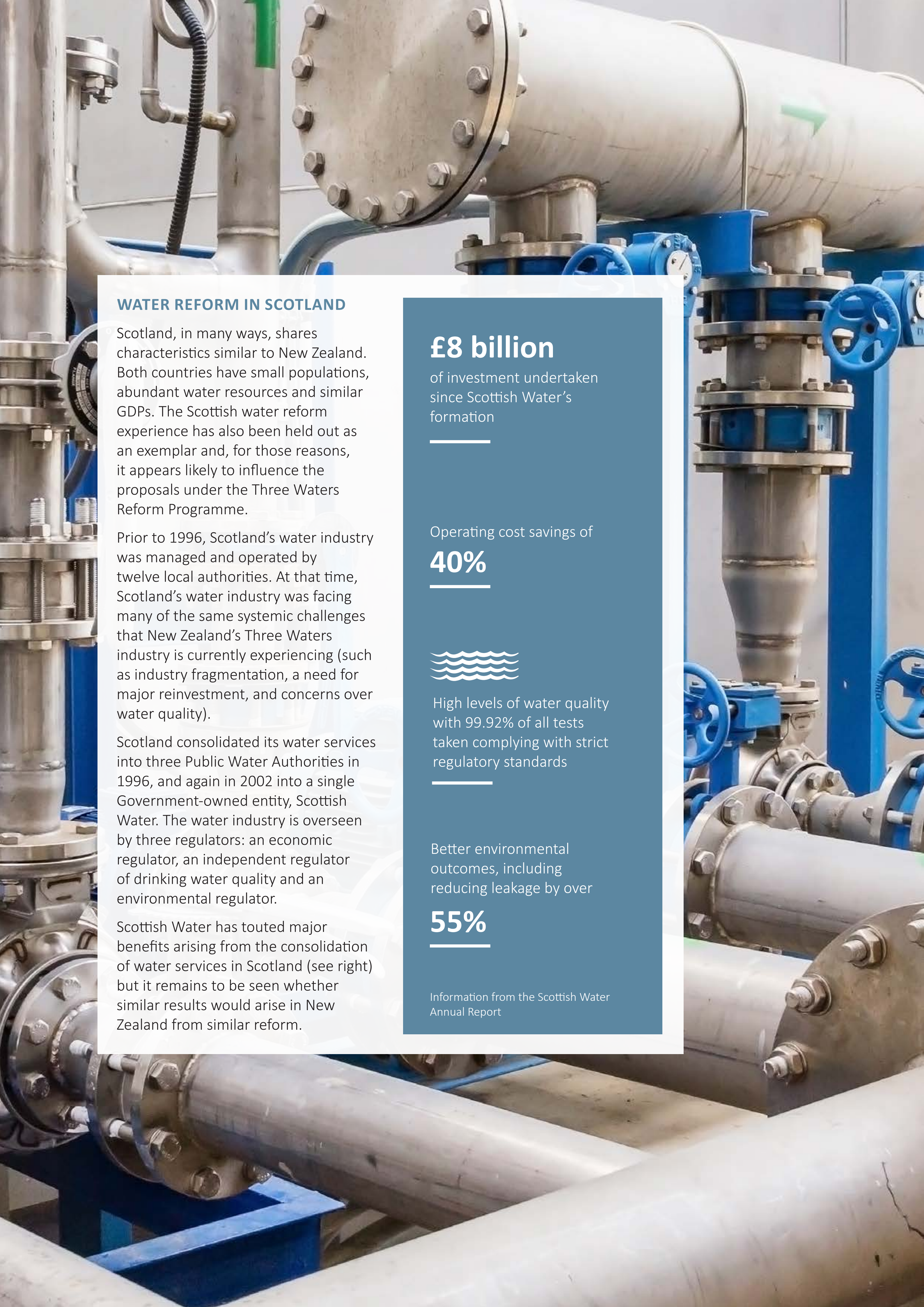
The three-year reform programme will be led by the Department of Internal Affairs working with a Three Waters Steering Committee to engage with key stakeholders, such as local government and iwi/Māori.

It will broadly be delivered in three tranches with the intention that new dedicated water entities will be fully operational by 1 July 2023:



The scale of the anticipated reform, and its complexity, should not be underestimated. It represents the largest reform to affect local government since 1989.

Each local authority will be impacted in a different way, depending on the state of its Three Waters assets, the extent of investment required, and the size of its rating base. The ability to navigate these issues in a way that addresses the interests of all affected parties – as well as striking an appropriate balance between the competing interests of critical mass, on the one hand, and local representation, on the other – will be fundamental to the success of the programme.



WATER REFORM IN SCOTLAND

Scotland, in many ways, shares characteristics similar to New Zealand. Both countries have small populations, abundant water resources and similar GDPs. The Scottish water reform experience has also been held out as an exemplar and, for those reasons, it appears likely to influence the proposals under the Three Waters Reform Programme.

Prior to 1996, Scotland's water industry was managed and operated by twelve local authorities. At that time, Scotland's water industry was facing many of the same systemic challenges that New Zealand's Three Waters industry is currently experiencing (such as industry fragmentation, a need for major reinvestment, and concerns over water quality).

Scotland consolidated its water services into three Public Water Authorities in 1996, and again in 2002 into a single Government-owned entity, Scottish Water. The water industry is overseen by three regulators: an economic regulator, an independent regulator of drinking water quality and an environmental regulator.

Scottish Water has touted major benefits arising from the consolidation of water services in Scotland (see right) but it remains to be seen whether similar results would arise in New Zealand from similar reform.

£8 billion

of investment undertaken since Scottish Water's formation

Operating cost savings of

40%

High levels of water quality with 99.92% of all tests taken complying with strict regulatory standards

Better environmental outcomes, including reducing leakage by over

55%

Information from the Scottish Water Annual Report

Spotlight on Climate Change

FUNDING FOR CLIMATE POSITIVE 'SHOVEL-READY' PROJECTS

New Zealand has an opportunity to emerge from Covid-19 with a stronger, more durable economy. As part of our recovery, on 4 September, the Government announced a principle list of 'shovel ready' projects that will receive $2.4 billion in funding from the Covid-19 Response and Recovery Fund.

The project allocated the most funding is the bundle of 12 regional Climate Resilience Packages which amounts to $212 million of the fund allocation. Other priority projects include $100 million for storage investment to enable 100% renewable electricity and $71.5 million for major cycleway routes.

The Government had earlier indicated a preference for climate positive projects such as water, transport, clean energy, and building projects. At least some of the proposed infrastructure project choices are based on future environmental expectations and align with New Zealand's climate change agenda.

IDENTIFYING THE RIGHT PROJECTS

Projects that can be implemented quickly, and that target households which have been particularly hard hit by the Government's response to the pandemic, are more likely to feed through directly to consumption.

Such projects are also more likely to align with New Zealand's Living Standards Framework and the UN Sustainable Development Goals, and positive effects for households and businesses can be harvested in the short term – eg projects that benefit SMEs but still support long-term goals of tackling climate change.

These projects are therefore likely to support people and business, and our climate.

Maximising benefits and minimising costs can also be achieved by focusing on infrastructure that improves energy efficiency. Options include environmentally-friendly transport-modes and improving transport safety and traffic fluidity technologies. Accordingly, around $590 million of the proposed projects are transport focused.

LONG TERM PRODUCTIVITY UNDER A TRANSITIONING ECONOMY

It will be important not to focus on projects which produce initial high employment results while construction is ongoing but are unproductive in the long term (described by the Chair of Crown Infrastructure Partners Limited as "bridges to nowhere").

These types of projects, once completed, can become economic dead-weights when long-term benefits fail to materialise. Projects likely to achieve support from the public and investors must therefore be those that strongly align with New Zealand's climate change priorities and vision for a sustainable economy.

They should drive efficient private capital investment by prioritising net zero emissions. In other words, investing in climate positive projects today means investing in the right projects for tomorrow's needs.

Whether long term productivity is achieved will become apparent as the projects progress. Indications are that this will be achievable to a large extent, but only if the risks from transitioning to a decarbonised domestic and global economy are taken into account by the proposed projects.

STATUTORY IMPERATIVE

The climate change-related policy and legislative environment in New Zealand has been evolving rapidly. As such, the regulatory framework is now largely in place, or planned, and the implementation of additional adjustments is imminent.

There are an increasing number of obligations being placed on both public and private sector decision makers with respect to addressing climate change-related risk. For example, in 2019, the New Zealand Government amended the Climate Change Response Act 2002 to enable decision makers to take New Zealand's net zero emissions by 2050 target into account. There is a reasonable prospect that the courts will find that the 2050 target (as well as the emissions budgets and emissions reduction plans once they are produced) is relevant to a range of central and local government decisions, and potentially a mandatory consideration in some cases.

We even see the potential for climate change to become a mandatory consideration by private sector decision makers. In addition, New Zealand will shortly introduce a mandatory disclosure regime for financial firms and listed companies. The regime will require disclosure of the climate-related financial impacts of climate change on their business and investments. This will enable markets to understand the financial risks posed by climate change, and is designed to ensure climate change risk, including the risk of a transitioning economy, is being adequately factored into business and investment decisions.

The impacts of this regime will continue to apply post Covid-19 and will provide New Zealand's businesses with a range of opportunities as the economy transitions to meet New Zealand's emissions reduction target.

Infrastructure – where to next

New Zealand, like the rest of the world, still has much to do to combat the ongoing impacts of Covid-19. The significance and scale of the challenge should not be underestimated.

This report, though, is focused on the next challenge – building towards a better New Zealand, with accelerated infrastructure reform and investment as a cornerstone of the recovery.

This is not a time for timid policies, and there is perhaps no better time than now to execute bold plans. As the saying goes, 'never waste a good crisis'.

With that in mind, we have highlighted ten focus areas (previewed in our wish list on page 5).

Invest now – Maximise the impact of the stimulus by enlarging the Covid-19 Response and Recovery Fund and extending the timeframe of the Covid-19 Recovery (Fast-Track Consenting) Act 2020.

Offer direction – Provide a special legislative case for major infrastructure within planning frameworks. Articulate when and how infrastructure may be provided for in more sensitive environments through national direction.

Act with urgency – Progress RMA reform as a priority, but acknowledge that new legislation will not be a silver-bullet. Through informed, non-partisan, debate we must recognise the importance of environmental resilience, and be willing to pay for climate-friendly outcomes.

Test new tools – Road-test the Infrastructure Levy Model on greenfields housing projects, but work on its application to more challenging brownfields projects where it may provide the most utility.

Build resilience – Promote a fair, efficient and equitable contracting environment that will provide greater resilience in the contracting sector.

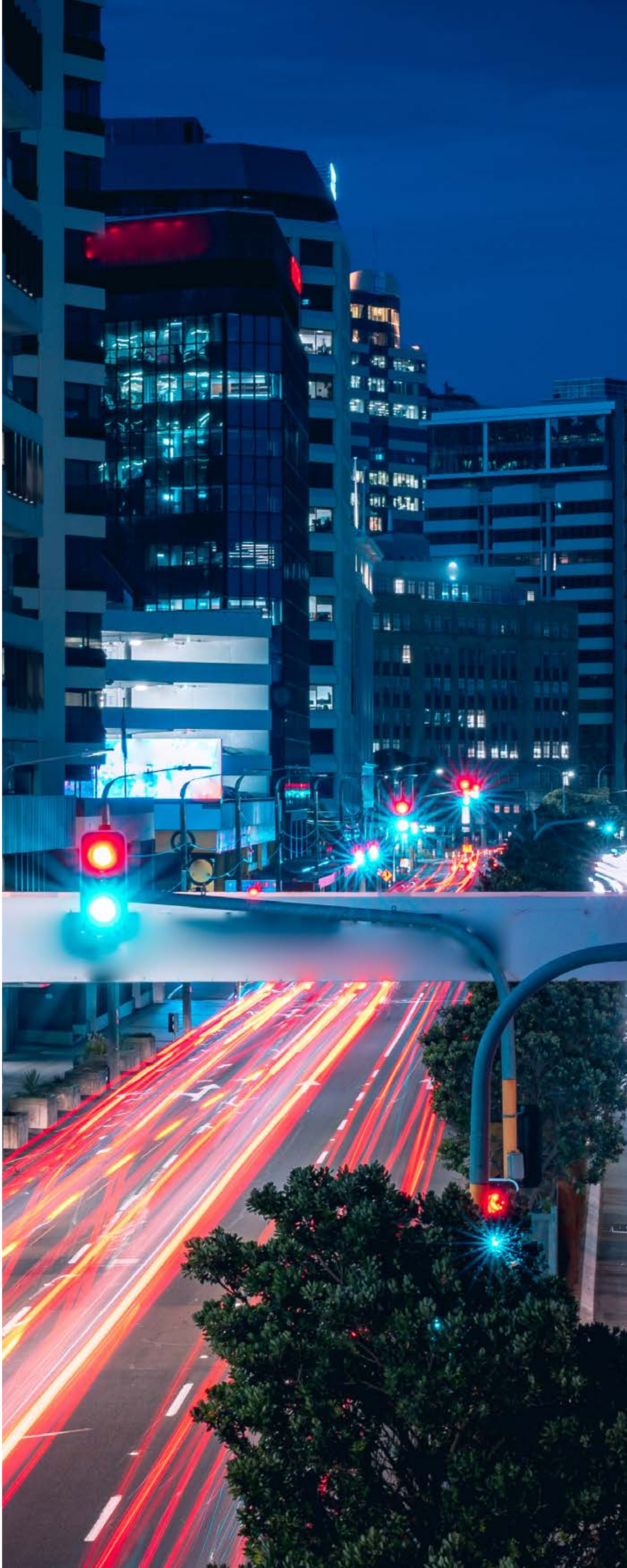
Entrust Te Waihanga – Provide Te Waihanga with the time and licence needed to influence our approach to infrastructure procurement using independent, evidence-based analysis – to help create a stable and consistent procurement environment free, as far as possible, from political whim.

Be bold – Continue to explore new channels to fund the infrastructure deficit – learning from value capture techniques used abroad.

Be resourceful – Review revenue policy settings to ensure we are optimising the potential for private investment to help bridge the infrastructure deficit.

Embrace Opportunity – Don't miss the Three Waters opportunity – engage meaningfully to identify a solution that will deliver the benefits of aggregation while recognising the New Zealand context and the benefits of local representation.

Think ahead – Further develop industry guidance on contract amendments – addressing Covid-19 issues and reflecting Construction Sector Accord principles.



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