Draft Incentives Framework

July 2013

This paper presents a first draft of the Incentives Fund Framework that Bay of Plenty Regional Council (BOPRC) staff are currently preparing for StAGs consideration on 16 July, prior to Council considering it on the 17 September.

This draft is incomplete. However, staff are seeking StAG's advice and recommendations on key aspects of the framework.

In particular, staff would like StAG's views on:

Feedback Required	
Aims, Principles and Approach	• What do you like and why? • What do you dislike and how would you improve them? • Is there anything else that should be included?
Variable vs fixed distribution	• Any proposed changes to staged distribution? • What aspects of variable rate do you like and dislike? • What aspects of fixed rate do you like and dislike?
Design Feature of Incentives Fund	• What aspects of the design criteria do StAG like and dislike, and why?

Confirmation	
Impact of allocation decision on Incentives Fund	• Confirm that decisions on higher allocation or sustainable load allocation impact on Incentives Fund.

Note: This document does not guarantee or commit the Rotorua Te Arawa Lakes Programme to any financial commitments.

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1. Purpose of Paper

The purpose of this paper is to seek feedback from the StAG group on the proposed framework on how to incentivise actions on rural land to achieve significant reductions in nutrient inputs to Lake Rotorua.

2. Background

The Deed of Funding

In 2008, the Ministry for the Environment (MfE) committed $72 million as part of a Deed of Funding arrangement with the Rotorua Te Arawa Lakes Strategy Group to meet the community's aspirations for water quality in four (4) priority lakes (Rotorua, Rotoiti, Rotoehu and Okareka).

Action Plans were developed in consultation with the community, consisting of in-lake and land-based interventions to reduce nutrients to each lake.

Land-based actions include sewage reticulation and reductions from rural land to reduce nutrient losses. Crown funding supported these actions to reduce nutrients from land. Bay of Plenty Regional Council (BOPRC) worked with willing individual landowners to assist with actions, which reduced nutrients.

In some of the smaller lake catchments, which required modest reductions from rural land, targets are achievable by working with individual landowners. Lake Rotorua has a much higher nitrogen reduction target. To meet the community's expectations for water quality, nitrogen to the lake needs to be reduced by 320 tonnes per annum. To meet the sustainable load, the pastoral sector has to reduce their nitrogen losses by around half (270 tonnes nitrogen).

In the Lake Rotorua / Rotoiti Action Plan, land-use change was initially set to achieve a reduction in nitrogen (N) of 170 tonnes with a budget of $9.5 million. To date, agreements have been secured for only a small reduction in N losses in the Rotorua catchment (4 tonnes by June 2012).

Since the Deed was signed in 2008, science and knowledge has evolved around what actions will be the most effective and cost efficient to achieve outcomes for Lake Rotorua. The original Deed was prescriptive and based on actions and budgets determined pre-2008. No flexibility was contained in the agreement to change actions or move budgets between actions if new information or science came to light.

The Rotorua Te Arawa Lakes Programme[1] is negotiating a new outcomes focussed Deed, which provides more flexibility to change actions implemented. As part of this, the Rotorua Te Arawa Lakes Strategy has requested to change actions for Lake Rotorua and move the funding from the Hamurana Diversion and Sediment capping to reductions from rural land.

In BOPRC's Ten Year Plan a revised work programme was detailed including a proposed $45.5 million budget to reduce nutrients to Lake Rotorua based on the above request. This funding is to be delivered over a ten year period.

[1] The Rotorua Te Arawa Lakes Programme is the operational programme which reports to the Rotorua Te Arawa Lakes Strategy Group.

The Proposed Regional Policy Statement

The proposed Regional Policy Statement has set the sustainable nitrogen limit to achieve water quality targets for Lake Rotorua at 435 tonnes of nitrogen and this limit must be reached by 2032. This equates to a 270 tonne reduction in N losses to the Lake from pastoral activities. To achieve this sustainable limit BOPRC is developing rules and incentives to reduce nutrients from rural land. The new Regional Water and Land Plan Rules, approved for development by BOPRC in 2012, will require nutrient reductions from land-based sources.

Section 6B of the proposed Regional Policy Statement states *"any land use change that is required within the Rotorua Te Arawa Lakes catchments to achieve the limits takes into account an equitable balance of public and private costs and benefits"*. The incentive is not expected to deliver the total nutrient reductions in the Lake Rotorua catchment. The Incentives Fund needs to provide a fair distribution between land-owner costs and community costs.

Possible Implications of the Rules

To reach these targets, the magnitude of change in the Lake Rotorua catchment is significant. It will have social, cultural and economic impacts, both locally as well as across the region. It is hard to estimate the true cost of this change to the pastoral sector with certainty because details on how the load to be managed by landowners will be allocated is not final, the precise context and financial situation on each farm is unknown and we don't know what practices will emerge to cost-effectively reduce N leaching or new low-leaching enterprises may emerge. We do know however, that the scale of change required means that achieving the sustainable load is not just about changing management approaches or adopting new technologies it will also require a significant shift in how land is used in the catchment.

It is highly unlikely that the $45.5 million budget for the proposed Incentives Fund is sufficient to fund the full cost of change required by rural landowners to reach the sustainable load. Therefore, there is an expectation that the pastoral sector needs to be at or below good practise levels before the Incentives Fund can be utilised by a landowner. The Incentives Fund will help fund the changes necessary to move from good practise or the allocated load (depending on final allocation approach used) to the sustainable nitrogen limit.

The future of Rotorua depends on both a clean lake and a healthy rural economy. The Council have a responsibility across the environmental, cultural, social and economic well-beings to ensure that rural landowners and the community have a viable future. The Incentives Fund will help rural landowners with the cost of making the necessary land-use changes on their properties to reach the sustainable load of N.

Allocation Approach

There are two allocation approaches, that are currently being discussed for the catchment and this document assumes both are based on some form of sectorial averaging; these two approaches are:

1. Allocate sustainable load of 435 tonnes of N between landowners in the catchment (sustainable load allocation).
2. Allocate an amount to landowners that is higher than the sustainable load (higher allocation).

The final allocation approach decided will have implications for the design of the Incentives Fund. For instance, where the sustainable load is allocated then the Incentives Fund would be used to assist farmers reach the sustainable load after they have met a good management requirement. Depending on how much higher the load is allocated the Fund may only be used to fund N reductions that are below the allocated level of N leaching.

Therefore, the details of how the Incentives Fund may work are likely to change once the allocation approach is chosen.

3. Incentives Framework

Aim of the Incentives Fund

The proposed aim of the Fund is to incentivise actions on rural land to achieve significant reductions in nitrogen inputs to Lake Rotorua.

The Incentives Fund will work in tandem with the development of new rules which will introduce lower nutrient-loss allowances from pastoral land. It is important that the Incentives Fund does not duplicate the intent of the new rules.

The Incentives Fund should help reach the sustainable load to Lake Rotorua by encouraging *investment* in projects (at both a farm and wider catchment level), that aid the transition to a low-nutrient rural economy for the Rotorua catchment. This should include a mixture of new investment and innovation (including innovation in technology, product design and marketing). This will help maximise the value to the economy of the target 256t N sustainable load of the Lake Rotorua catchment, and it is this investment / innovation gap that the Incentives Fund could address.

Conversely, the aim of the fund is ***not*** to:

- Compensate for the financial impacts of the rules (as noted earlier, the Incentives Fund is not sufficient for this)
- Achieve the total reduction in nutrient discharges to the lake for the catchment

The Incentives Fund will achieve nitrogen reductions in the catchment by:

- Creating a *"leading"* group of farmers to demonstrate the efficacy of new mitigation practices and technologies on reducing nitrogen leaching and profitability, as well as how to successfully implement these practices
- Encouraging *early adoption* of low-nutrient-loss strategies for rural land to achieve 70% of the nutrient-loss target by 2022

The Incentives Fund should be used:

- In conjunction with co-funding from landowners themselves and / or other investors
- To support projects that retain the benefits of the Fund within the Rotorua economy, and, where possible, foster employment and stronger local communities

Principles

The Incentives Fund will be managed according to the following principles:

- Operate using an *open and transparent* process – information will be readily available about how proposals will be assessed and decisions made. Fund mechanisms will encourage greatest nutrient reductions.
- *Well-governed* – there will be clear governance structures and accountability for decisions around the use of funding.

- *Equity and fairness* - the Fund will be open to all landowners who are likely to be affected by nutrient reduction rules and there will be equal opportunities for landowners to apply for funding.
- Ensure that funds are spent in a *cost-effective* manner with efficient administration and management to ensure funding is used for the purpose intended.
- *Adaptively managed* – the Fund will remain responsive to a range of opportunities and open to new approaches as they emerge.

Funding Decision

Funding decisions will be made based on the following criteria:

1. Actions will be incentivised to get to the catchments sustainable load, but will not cover the cost to reach good practice levels. The Fund will target the gap between the allocated target[2], and the sustainable load for the lake (as required by the rules)
2. Preference will be given to lower cost actions based on cost per kilogram of nitrogen reduced and those that provide significant levels of N reductions
3. Reductions must be quantifiable – e.g. through Overseer or another scientifically proven nutrient measurement system
4. Regardless of nutrient reduction actions being proposed the Fund will only pay for a portion of the cost of those actions
5. Perpetuity – only permanent reductions will be funded
6. Nutrient reduction proposals that can demonstrate other co-benefits will be favoured, including economic, social and cultural
7. Gorse conversion will not be funded through the Incentives Fund[3]

What aspects do members of StAG:

- Like about the Aims, Principle and Approach to decisions, and why?
- Dislike about the Aims, Principles and Approach, why and how would you improve them?
- What else would you like added?

[2] If the allocated level is higher than the sustainable load the Incentives Fund will focus on reductions in N losses below the allocated limit.

[3] As N leaching from gorse is not accounted for in Overseer and has not been factored into the estimation of N leaching from rural land, BOPRC staff have recommended that the removal of gorse should be addressed using mechanisms outside of the Incentives Fund.

4. Interdependencies with Allocation and Rules

Allocation

The amount of nitrogen allocated to land use in the catchment will impact on the design of the Incentives Fund and how it operates.

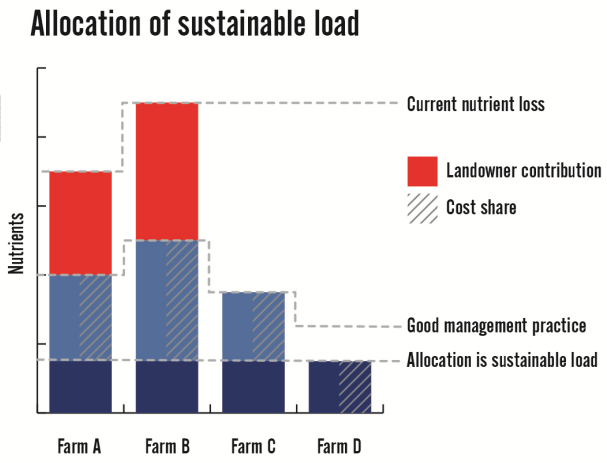
Staff are working with the StAG sub-committee on the development of two (2) approaches to allocation for Council's recommendation:

1. *Sustainable load allocation* - allocate 256 tonnes of nitrogen for pastoral land use. This means that every landowner in the catchment must significantly reduce nitrogen losses. The Incentives Fund will cover some costs to landowners to help make the necessary changes. The spectrum covered in this scenario by the Incentives Fund would be broader. Regardless of Incentives, the Rules will ensure that the sustainable nitrogen load to the lake is met by 2032.
2. *Higher allocation* - allocate higher than the 256 tonnes of nitrogen for pastoral land use. In this scenario, the Incentives must deliver the balance of nutrients required to meet the target sustainable load. This option spreads the risk and allows some landowners to farm at allocated levels, but we will be relying on other landowners to voluntary (with the financial assistance of the Incentives Fund) reduce nitrogen to lower nutrient leaching activities.

Sustainable Load Allocation

If the allocation mechanism allocates the sustainable load between landowners then the Incentives Fund will share the costs (after meeting a good management practice requirement[4]) up to $45.5million to meet this allocated target.

Graph 1 – Proposed Approach to Funding Under Sustainable Load Allocation



[4] This would be defined at a property level based on a generic sector generated equivalent of Good Management Practice or some other equal effort level.

Graph 1 show how the Incentives Fund could operate at the property level to share the costs to reach the targets[5]. The Incentives Fund would only be used to support actions that reduce N losses to below good management practices levels. Therefore, Farms A and B would be required to reduce their N losses by the amount in red before the Incentives Fund could be used. The landowners could either reduce their N leaching by the amount in red before applying to the Fund or only request funding for those reductions that are below those achieved through good management. Farms C and D are eligible to apply for funding for any actions that further reduce their N leaching. In the case of Farm D, this can be for actions that reduce their N leaching to below their allocated load.

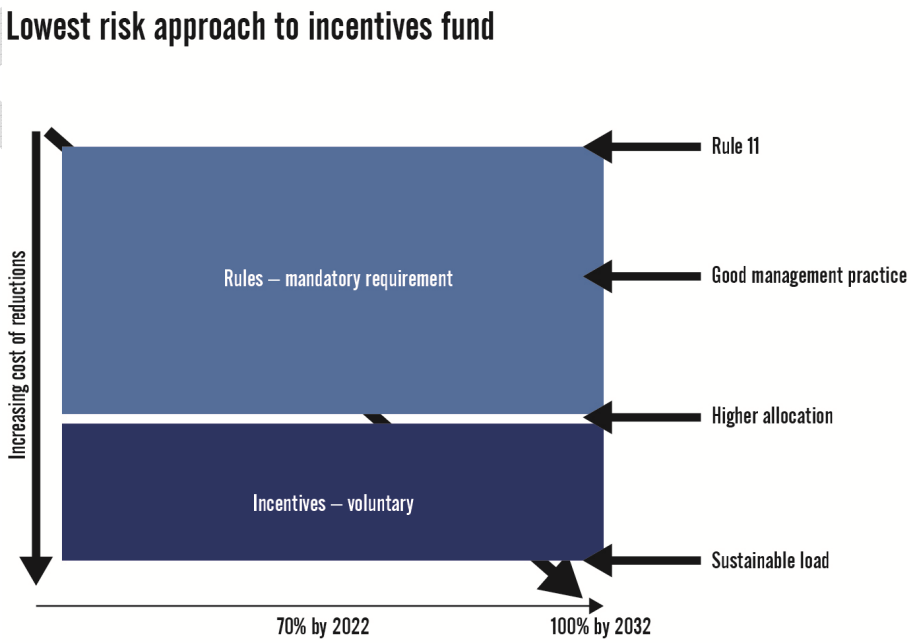
The graph also shows that the Incentives Fund will be based on a cost-share payment. In this instance, it is a 50% cost-share meaning that the landowner pays 50% of the cost of the actions and the Fund pays the other 50%.

Higher than Sustainable Load Allocation

If more than, the sustainable load of nutrients is allocated to landowners; it will change how the Incentives Fund will operate. Under this scenario, landowners will have to reach their allocated loads before the Incentives Fund can be used. The Fund will only pay for the balance between the allocated load and the sustainable load (or lower).

If the allocated load is higher than the sustainable load there will be an on-going assessment of the progress towards landowners meeting their allocated load. If, by 2022, less than 70% of the sustainable load in the catchment has not been reached then the allocated loads for all landowners will be revised down to the sustainable load. This will increase the N reduction target that landowners will have to achieve.

Figure 1 – Low Risk Approach to Higher Allocation



[5] Note the graph assumes sectoral allocation without any modification.

Figure 1[6] shows a prudent approach to spending Incentives Funding in the higher allocation scenario.

The Incentives Fund would only be used to achieve reductions below the higher allocated load and the sustainable load. Therefore, landowners will face the liability of achieving their allocated load and the Fund assumes the responsibility (and risk) of achieving the sustainable load. Given the reductions are likely to be more expensive than those to achieve their allocated load, the Incentives Fund will need to spend its funds prudently to ensure that there is sufficient financial incentive available to landowners to undertake these more expensive reductions.

Table 1 – Farm Level Impact of Higher Allocation on Funding

Farm	Existing N Leaching	Allocated Load	Eligible Reduction	% Funding
Farm A	45 kg/n/ha	35 kg/n/ha	-	-
Farm B	38 kg/n/ha	35 kg/n/ha	35- 14 kg	95%
Farm C	40 kg/n/ha	35 kg/n/ha	35-10 kg	60%
Farm D	18 kg/n/ha	13 kg/n/ha	13-10 kg	100%

In Table 1 above, Famer B voluntarily makes investments to achieve lower reductions than allocated and it is good value for money so the Incentives Fund pays 95% of the costs of the action. In the case of Farmer C, the landowner wants to make significantly reductions but the actions are very expensive exceed the cap on spending and the fund can only pay a portion of the cost, but may pay more per kg than Farm B.

In the higher allocation option, the sustainable load is not allocated on an individual basis but will be achieved by amalgamating all nutrients reduced below the higher allocation level.

The risk and requirement for a prudent approach to funding fluctuates depending on the size of the gap between the higher allocation and the sustainable load; for example:

- The smaller the gap between the higher allocation and the sustainable load the lower the risk of not achieving the sustainable load with available funds.
- The larger the gap (higher the allocation) the greater risk that the Incentives Fund will not reach the sustainable load target.

Figure 1 earlier assumes a balanced approach, where the target is a stretch target for landowners to achieve and is also a stretch target for the Incentives Fund.

No decisions have been made about the amount of nutrients proposed to be allocated under a high allocation option, nor have decisions been made on the ability of rural land owners to meet these targets.

[6] Graph 2 assumes that the allocation is made on an unmodified sector average.

However under a higher allocation option staff prefer a risk adverse approach to the Incentives Fund where funding is provided to assist landowners reduce nutrient below their higher allocation only. If this was the preferred approach staff could investigate other forms of assistance[7] to support land owners reach higher allocation limits.

The reason that this option is preferred is it reduces the risk of not meeting the sustainable load due to insufficient funds. This is a real risk given the costs of reducing nutrients at the marginal levels is high and costs are likely to increase over time. It also provides more clarity as the incentives fund is not duplicating the efforts of the rules.

Rules

Whichever allocation approach is chosen, there will be on going interdependences between the Rules and Incentives Fund.

To manage nutrient reductions, whether authorised by rules or voluntary agreement, we must be able to monitor discharges and be able to ensure compliance of them. To do this it is likely that the new Regional Water and Land Plan Rules (the Rules) will require on going monitoring and compliance.

The incentives reductions, once negotiated, will use established BOPRC systems and processes to monitor compliance.

[7] Assistance which does not erode the total quantum of funding of funding could be available for land-owners who are unable to reach the higher allocation level. This could include interest free loans, expert advice and technical support.

5. Distribution of Funds

This paper outlines the preferred approach to distribution of Incentives Fund, and seeks to obtain feedback from StAG on:

1. Fixed / Flat Rate, or
2. Variable Rate

Staff preference is for a staged distribution with a variable rate. These are discussed in more detail in the sections below.

Staged Distribution

Staff propose a staged distribution of funds where the funding is distributed over a period of time. Councillors have already expressed a preference for a staged distribution of funds by approving the funding to be spread across ten years in the Deed and the Ten Year Plan. How the funding is staged could vary, e.g., at specific intervals during the 10 years (status quo) or approval could be sought for longer timeframes.

The advantages of a staged distribution are that it allows those who are ready to make changes to have access to funding as soon as the Incentives Fund becomes operational. It also allows time for those who are not sure of what actions they may like to implement to consider options without fear of missing out on funding (and potentially making poor decisions as a result). The Council also has the opportunity to learn from early funding rounds to improve the process for allocating the Fund. Over time the fund can be tailored to achieve different outcomes and reduce inequity, should it become necessary.

For example, it may become evident that certain groups are not applying for the funding. In that instance, then a funding round could be designed to specifically target that group (after some assessment had been undertaken as to why that group had not participated). Using Māori landowners as an example, if Māori landowners have not applied for any funding after five (5) years a tranche of funding (with the same eligibility criteria) could be run for Māori land only.

This approach also provides time for the development of new technologies that could reduce nutrient losses at a reduced cost.

The Benefits of Staged Distribution

- Enables a more tailored approach and could use a variety of distribution mechanisms to target particular types of mitigation or investment, or particular sub-groups of landowners (by sector, ownership or, change) and would enable the overall programme to be modified in response to feedback.
- Aligns with status quo in the Deed and the Ten Year Plan, which allocates funding in 10 lump sums over 10 years (See Appendix 1).
- Allows the Fund to be reviewed and adjusted depending on the findings of the review.

- Allows landowners who wish to take up the Fund in later years to do so.
- Allows changes in external factors, such as technological change, to be taken into account.
- Significantly reduces risk to Council by not "putting all eggs in one basket".

The Risks of Staged Distribution

- Increase in administration costs for on-going assessment and delivery of funding
- Lower level of certainty for landowner
- Inflation – the money will potentially buy less in later years as the value of the fund decreases

Staged distribution is preferred to a single distribution where all the available funds are distributed amongst the catchment in a one-off process. This gives the Council only one chance to develop a fair system and no opportunity to apply lessons learned. This option does not align with the draft Deed of Funding which does not allow for the total fund to be released at once (See Appendix 2 for further detail).

- What aspects of Staged distributions do StAG members like?
- What aspects of Staged distribution do StAG dislike and how could this be improved?
- Do StAG members have a preference for time scale, 5 years, 10 years (status quo), or longer?

Variable Rate

The preferred approach to distributing funds is to use a variable rate where the funding provided is tailored to individual applications. Landowners would be invited to prepare or update existing Nutrient Management Plans, which demonstrate how they propose reducing nutrient leaching across their whole property to a lower level (based on their allocated loads). These plans would include the actions eligible for funding (based on their allocated loads) which would be audited over time, and the costs of implementing the eligible actions. The Fund would contribute a percentage of these costs under a cost-share agreement.

There would be scope for negotiation over elements of the Nutrient Management Plan (e.g. where best management practices have yet to be implemented), and, although Fund Managers would operate within agreed parameters, there could be also be some discretion over the cost-sharing percentage to be applied in each case. These details would be further refined during the implementation planning phase.

The Benefits of a Variable Rate

- Variable rate allows the characteristics of individual properties to be factored in (e.g. characteristics of the land, current and proposed management practices, and the level of investment required for infrastructure). This should lead to a more efficient and cost effective use of the available funds. The marginal costs of reducing nutrient loss will vary from farm to farm, and the capacity to develop a unique cost-sharing "package" should mean that the price per kilo approximates to this marginal cost. This provides mechanisms for those landowners who face higher costs than others, to receive funding in line with their needs.
- Enable payment based on real costs of change so there will be less risk of windfall gains for some and not enough for others. It is therefore fairer and more equitable than flat rate.
- Adaptive to individual landowner needs (and aligns with the principle of adaptive management, which underpins the MOU with the Crown, and the idea of being open to new approaches).
- Incentivises gains in nutrient-efficiency, rather than simply reductions in nutrient-loss. This is because it provides more incentive to identify innovative ways to reduce the nutrient losses cost-effectively.
- Ensure we only pay for the cost of the actions not the nutrients. If a new technology allows farmers to decrease significant nutrient at small cost then we pay the cost of change.

The Risks of a Variable Rate

- Perceived price uncertainty by landowners. However, as the cost-share rates will be known and specified for the Fund, landowners will be able to determine the amounts that can receive.
- Landowners may not have resources or ability to determine the actual cost of change (including the estimated impacts of farm profitability). However, given that farm input and output prices are highly variable any estimation today could be different tomorrow depending on external price fluctuations. The Incentives Fund Assessment Panel will have the discretion to query requests that appear too high or too low, thereby providing some level of assurance that low offers will be questioned.

A variable rate is preferred to a flat-rate distribution, where all landowners are awarded a set amount of funding calculated by a standard formula (e.g. $300 per kilogram of nitrogen for dairy farms, should a sectoral approach be also used for the Incentives Fund). The landowner then uses that funding to achieve the *sustainable* load of nitrogen using any method they see fit. In some instances, the Fund may cover all or most of their costs while for some landowners it may only cover a small portion of their costs.

A flat-rate distribution will provide certainty to farmers about the price they will receive, regardless of the actions they take. However, it does ignore any differences in investment and cost of change between landowners and any inequities that arise from this funding approach. Therefore, it is inconsistent with the requirement of "cost efficient reductions" and the principle of "fairness and equity" it also does not align with adaptive approaches to Funding (see Appendix 3).

Another weakness of fixed rate is that it limits any available nitrogen cheaper than the flat rate. For example, if a flat rate is set at $300 per Kg of nitrogen, a farmer who can reduce nutrient at a cost of only $150 is not going to sell it to his neighbour in need.

- What aspects of variable rate do StAG members like and dislike?
- What aspects of fixed rate do StAG members like and dislike?
- Which approach is preferred by StAG?

6. Design Features of the Incentives Fund

Staff are seeking approval from Council for the high-level design principles and features for the Fund in September 2012; and seeks to obtain some feedback from StAG first on:

1. Eligibility - who is eligible for the Incentives Fund?
2. Security - what conditions will apply to ensure that we achieve nutrient reduction targets for the Incentives Fund?
3. Distribution – what mechanisms can be used to distribute the Incentives Fund?

Further decisions and approval will be required for the implementation planning stage at a later date.

Eligibility

Applications are not limited to individual landowners and may be joint ventures (e.g. landowners and investors), or public - private partnerships (e.g. landowners and council) but must comply with the following eligibility criteria:

- All land covered by the application must be contained within the Rotorua groundwater catchment.
- All applicants must demonstrate that the reductions are below their allocated nitrogen load for that parcel of land.
- Applications are for diffuse nutrient discharges only (point sources such as septic tanks and dairy shed effluent ponds are not eligible)
- Applications must achieve significant reductions in N. For the Fund, significant will refer to estimated N loss being over 10 - 30% of land parcel's Overseer file at agreed level (depending on preferred allocation) and is greater than 500kg.
- The proposal is compliant with all Regional Water and Land Plan rules.

Security

All Incentives Fund recipients will be subject to conditions relating to the use of the funding. Two obligations will be required to protect the public funds and ensure that the nutrient leaching reductions are permanent:

- Rules under the Regional Plan will secure the leaching reduction under the Resource Management Act, regardless of preferred allocation.

- A commercial agreement will be used to facilitate the transaction, specify the conditions of the Incentives Fund, and require the execution of enduring contractual documentation. The longer-term strategic purpose of this contractual framework is also to ensure that future changes to the RMA regime do not adversely affect the leaching reductions that are achieved (which would render the funds spent ineffective). This contractual framework will not make the operational or compliance aspects of the landowner's business more onerous than that required of them under the Resource Management Act. It will however, ensure the permanence of the reductions.

The agreement will contain as a minimum:

- The payments to be made from the Fund to the landowner at a specified cost-share amount
- The total level of nutrient loss reduction (as above this must be significant and measurable) that the Fund in funding (both what the landowner and the Fund is paying for)
- A nutrient management plan describing the mitigation activities to be funded (or an obligation to complete such a plan)

The execution of:

- A deed that survives in perpetuity and records the nutrient reduction but excludes the commercial terms that are in the agreement (perpetuity for this Fund will be defined as 999 years)
- If appropriate, an encumbrance to be registered on the title to the land (this references back to the deed); and
- If appropriate, and forestry is involved, a "default" forestry right providing the right to remedy any failure in planting and retain rights to the planted forest

There may be further conditions identified during the development of the Implementation Plan that would need to be included in this contractual agreement.

7. Next Steps

Staff will take StAG's feedback from the 16 July 2013 meeting on board and make amendments were possible to the Incentives Fund Framework. The Framework will then come back to StAG in August for further consideration before being presented to Councils Strategic Policy and Planning (SPP) Committee for approval on 17 September 2013.

If SPP supports the proposed Incentives Fund Framework on 17 September 2013, staff will work with StAG to develop an Implementation Plan for Councils consideration and approval.

Some areas to be covered during the implementation planning phase include:

- Internal BOPRC needs to operate the Incentives Fund (e.g. required staff, new process to distribute funding, legal advice)
- Governance structure for management of the Fund
- Formal details on how the Incentives Fund links to the Rules (and potential mechanisms such as water quality trading)
- Number and frequency of funding rounds, including estimated funds available for each round
- Provide options for how to assess applications
- Operational rules (such as process should all the funding in a round not be spent)
- Processes for advertising new rounds, managing applications and scoring applications
- Finalise the terms of the contractual agreement, including compliance requirements
- Composition of the Assessment Panel to determine which applications are successful (and remuneration for that service)
- Review processes that will assess the success of the Fund (including what will be reviewed and how often)

8. Appendix 1

Rotorua Lakes - Nutrient reduction from agriculture expenditure for Lake Rotorua

Year One 2012/13	Year Two 2013/14	Year Three 2014/15	Year Four 2015/16	Year Five 2016/17
$1.7 million	$4.86 million	$4.86 million	$4.86 million	$4.86 million
Year Six 2017/18	**Year Seven 2018/19**	**Year Eight 2019/20**	**Year Nine 2020/21**	**Year Ten 2021/22**
$4.86 million	$4.86 million	$4.86 million	$4.86 million	$4.92 million
Total	**$45.5 million**[1]			

1. *Total expenditure will be funded 50 percent by Central Government, in accordance with the approved Government Deed, and 50 percent by Regional Council.*

These figures are included in the Sustainable Water Management Activity Financial Statement operating expenditure by programme for Rotorua Lakes shown on the following page.

9. Appendix 2

Table 2 and 3 outline the advantages and disadvantages of a Single vs. Staged Distribution and a Flat vs. Variable Rate.

Table 2 – Advantages and Disadvantages of a Single vs. Staged Distribution

	Single Distribution	Staged Distribution
Advantages	• A single large distribution would see all of the available funds distributed amongst the catchment in a one off process. • If sustainable load allocation is preferred, the advantage is it will provide maximum certainty to landowners regarding the resources they will have to achieve their future obligations under the nutrient-loss rules, and leave them to find the solutions that best fit them within whatever conditions are applied. • Administrative costs to deliver funding would be constrained to a single financial year, reducing on-going cost of funding administration.	• Can steer the process towards funding activities with the highest return, remedy mistakes, and apply lessons learned along the way. • Staged funding aligns with status quo in the Deed and the Ten Year Plan and would require no change. • Allow reviews of implementation to be carried out and these can be built into the implementation plan.
Disadvantages	• Places heavy emphasis on developing a funding formula that is generally perceived as fair. • This cannot work if higher allocation is preferred. We don't know who to distribute funds to. • High risk to council as there is only one chance to get it right, once it is distributed there is no opportunity for review and refinement.	• Disadvantages are an increase in resources required over a ten year period which will increase administrative cost to delivery. • Nature and timing of the Stages would need to be signalled in advance if it is to provide a high level of certainty to landowners.

	Single Distribution	Staged Distribution
Disadvantages cont….	• Does not align with Ten Year Plan and Deed of Funding agreement with the Crown. • Risk that we will not get approval to spend in one distribution.	• A multiplicity of funding mechanisms and "programmes within programmes" while enabling a degree of tailoring to individual landowners, could create some lack of clarity.

10. Appendix 3

	Flat Rate	Variable Rate
Advantages	• Possibly cheaper and easy to administer (note this can also be delivered through variable distribution). • There is transparency from the outset to enable all farmers to make mitigation decisions. • Farmers perceive it as less risk. Tender based schemes can become virtual flat rate schemes – but with greater costs – once the market price becomes well known.	• Allows the characteristics of individual properties to be factored in. For example, characteristics of the land itself, current and proposed management practices, and the level of investment in infrastructure. • More efficient and cost effective use of the available funds. The marginal costs of reducing nutrient loss will vary from farm to farm, and the capacity to develop a unique cost-sharing "package" should mean that the price per kilo approximates to this marginal cost. • Considers the unique features of each farm; which will result in appropriate price being paid • From a wider economic point of view, a variable rate approach would incentivise *gains in nutrient-efficiency*, rather than simply *reductions in nutrient-loss*.
Disadvantages	• Not equitable as it does not account for the differences in investment and cost of change. • Inconsistent with current preference in allocation which does not prefer average allocation • A flat rate scheme requires an additional pricing tier to avoid paying "too much" for cheaper actions.	• Different prices being paid per kilo of nutrient may appear unfair and the rationale for this will need to be transparent. • It would require more management from the need for up-front planning and negotiation.

	Flat Rate	Variable Rate
Disadvantages cont….	• There is risk to Council in setting the flat rate(s) too high or too low. This creates inequities.	

Approach to Decisions	Flat Rate	Variable
Nitrogen reduction to good management practice will not be incentivised	✓	✓
The most nitrogen reduction per dollar		✓
Reductions must be clear, quantifiable and measurable		✓
We will only pay for the demonstrated cost of change		✓
Perpetuity – we will fund for activities that will achieve permanent reductions	✓	✓
Co-benefits – proposals with other social, economic and cultural benefits will be valued		✓
Will not fund gorse	**Once funding is given out no guarantee it won't be spent removing gorse**	✓