Briefing to Incoming Minister
Information Release

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THE TREASURY
Kaitohutohu Kaupapa Rawa

Gabriel Makhlouf
Secretary to the Treasury

31 October 2017

Hon Shane Jones
Minister for Infrastructure
Parliament Buildings
Wellington

Dear Minister,

Congratulations on your appointment as the Minister for Infrastructure. We look forward to working with you in your new role.

Infrastructure impacts the living standards of all New Zealanders: it is critical to all aspects of modern living, allowing us to enjoy the quality of life we have become accustomed to and providing a platform that enables us to compete in the global economy. Every New Zealander uses infrastructure on a daily basis – it forms the backbone of all New Zealand communities, and every New Zealander needs a greater level of confidence about the cost, service levels and resilience of infrastructure.

I attach a briefing that reflects what we have heard from you and your government partners during the election campaign, and how we can help support your agenda. We look forward to discussing these matters with you further.

Yours sincerely,

Gabriel Makhlouf

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Briefing for the Incoming Minister for Infrastructure

October 2017

Introduction

In this document we outline your role as Minister for Infrastructure and provide context on the current performance of the sector.

We have also provided our advice on how we can best support you to deliver on the Government's agenda, and identified what we see as priority issues.

We view this document as a starting point for an ongoing conversation with you. We look forward to opportunities to discuss the matters identified below in more detail.

Your role as Minister for Infrastructure

The role of Minister for Infrastructure is to shape and develop a strategy for infrastructure delivered by central government, local government and the private sector. The role has no statutory roles, powers or duties.You are supported by a number of portfolio Ministers who have statutory responsibilities for infrastructure issues within their portfolios.

To inform your infrastructure strategy, we recommend that you bring together this group of Ministers to discuss portfolio-related matters that have a wider impact on infrastructure strategy.

You also appoint the National Infrastructure Advisory Board (NIAB). NIAB provides advice on the performance of infrastructure based on its members' involvement in the sector. NIAB is presently made up of senior professionals from the private sector and outside central government. NIAB is purely advisory and has no statutory authority. More information on NIAB is attached in Appendix 2.

The state of infrastructure

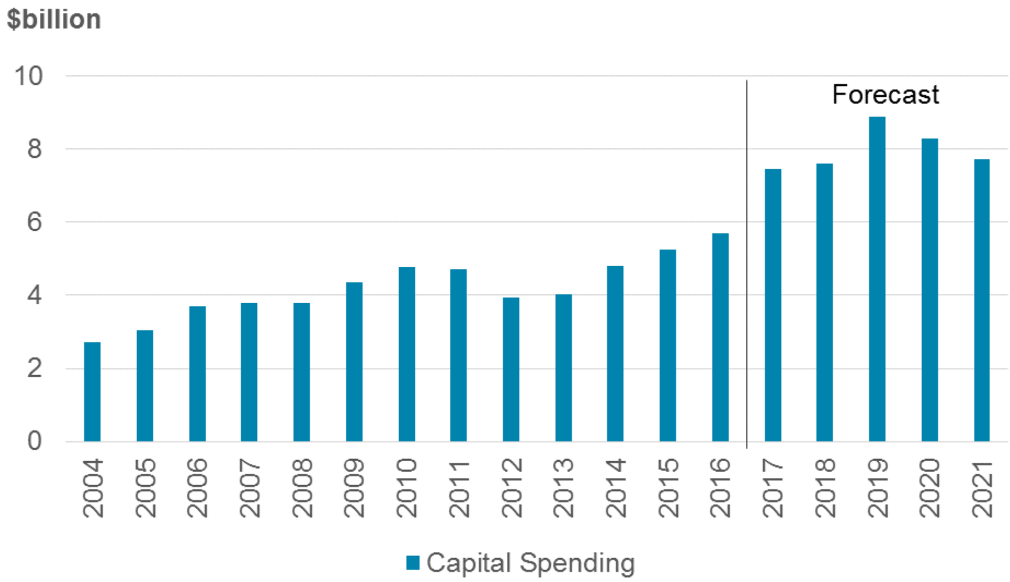
Infrastructure typically includes fixed, long-lived structures that facilitate the production of goods and services. More specifically, infrastructure refers to physical network infrastructure, principally transport, water and energy, communications and the capital intensive investments that central government is generally responsible for, such as schools, hospitals and prisons.

The quality of our infrastructure plays a critical role in our living standards, and impacts on the physical, financial, social, natural and human capitals that underpin living standards.

Central government infrastructure is largely funded by taxes and local government by rates, although both sectors also have a variety of user charging mechanisms. The significant exception is the National Land Transport Fund, which funds State highways, 50% of local roads and public transport via road user charges and fuel excise duty (forms of user charging) and is administered by the NZ Transport Agency.

Between 2014 and 2016, every region's projection of how much they would need to spend on local government infrastructure by 2025 grew year on year. The only exceptions were Taranaki and Marlborough. This partly reflects that much of our infrastructure is ageing and will need renewing around the same time.

Figure 1: Historical and forecast infrastructure investment by central government



Total Crown assets are forecast to grow by $38.6 billion to $331.3 billion in 2020/21, made up of additional investments in assets, both physical and financial. The largest asset growth over the forecast period is in the social assets portfolio (eg, schools, hospitals and social housing), which makes up just over 50% of the total Crown balance sheet. Social assets are expected to increase by $24.7 billion over the forecast period to be $174.1 billion in 2020/21. This increase largely reflects growing capital spending.

Increased spending reflects several challenges that central government and local authorities will face over the next 30 years. The current Thirty-Year Infrastructure Plan 2015 ("the Plan") identifies these challenges and sets a vision for responding to those challenges.

Economic growth will be more concentrated in certain regions, especially Auckland, Hamilton, Tauranga, Wellington, Christchurch and Queenstown. This will create infrastructure pressures in housing, the three waters and transport. Our view is that the greatest short-term wins from a national productivity perspective come from unlocking housing supply and infrastructure pressure points in these areas.

Many regional areas face different challenges from those experienced in growth areas. Regions with low growth and a shrinking ratepayer base face challenges in deciding whether and how to renew or replace infrastructure. While we plan for growth, we must also consider opportunities that enable declining regions to continue delivering the appropriate levels of infrastructure services despite declining ratepayer bases.

Other challenges our economy faces over the next 30 years include ongoing funding constraints and an ageing population. Also, to keep our economy growing, our infrastructure needs to support increased productivity. At the same time, technology is transforming the way infrastructure providers deliver services. Finally, our climate is changing, and our natural resources are under pressure, which will create new challenges for infrastructure planning.

The Plan concludes that, to respond to these challenges, we need a more sophisticated approach to planning, developing and managing our infrastructure. This includes having an overriding focus on the outcomes we want to achieve, rather than the assets used to deliver them. This can be achieved by infrastructure providers in central government, local government and the private sector:

- increasing understanding of levels of service and future drivers of demand over the long term
- strengthening asset management practices and using data more effectively, and
- optimising decision making, which includes having the right governance and management structures and regulatory regimes in place.

The Plan's vision is outlined in more detail in Appendix 1.

The performance and long-term needs of New Zealand's infrastructure, as outlined in the Plan, is monitored by the Treasury. We support you with strategic advice across the infrastructure sector as defined above. By taking a high-level view of the overall performance of the sector, we complement the work of the infrastructure line agencies embedded within their sectors and managing operational issues.

How We Can Help Deliver Your Agenda

We note your commitment to lifting the productivity of regions through investment in regional rail, ports and other capital investments, funded by an annual $1 billion Regional Development (Provincial Growth) Fund. We also note commitments made by your government partners to invest in rail infrastructure and walking and cycling networks in regions and cities.

In this section, we raise a number of issues designed to ensure you have a strong basis from which you can deliver your infrastructure programme. In summary, these are:

- delivering greater certainty and consistency in the planning system
- making public and third-party capital available for infrastructure investment, and
- lifting the performance of procurement.

Delivering greater certainty and consistency in the planning system

To enable central and local government to more easily respond to demand for infrastructure, we recommend pursuing a fundamental review of the planning framework.

A review would focus on creating a system that is more cohesive and coherent, is better aligned across legislative roles and responsibilities, produces better decision-making outcomes and is more agile and durable for the future. Given the unique pressures our growth areas are facing, there is a strong case for beginning with a focus on urban issues such as housing and infrastructure.

For regions, a better planning system may mean more certainty that the right levels of infrastructure are planned, funded and delivered over the long term, despite declining ratepayer bases. It may also mean regions with declining populations developing integrated plans with neighbouring regions to better utilise the infrastructure assets across regions and achieving scale.

While more work is required to ensure we can better respond to infrastructure demand in the short to medium term, a reformed planning system is the basis of a better system in the long term.

Making public and third-party capital available for infrastructure investment

We note that the $1 billion annual Regional Development (Provincial Growth) Fund, administered by you, will in part be allocated to regional infrastructure capital investment.

We expect that the Ministry of Business, Innovation and Employment will lead the development of policy advice to you on this. But we would like to discuss with you how cost-benefit analysis and the use of well-developed business cases can ensure you are fully maximising the opportunities from the Fund.

We also note the Labour Party's commitment to issuing infrastructure bonds to fund horizontal infrastructure that supports housing. This would be repaid through targeted rates.

We understand the objective of infrastructure bonds is to accelerate development to support housing supply in growth areas while minimising further debts on councils' balance sheets. This model would seek to accomplish this by investing in infrastructure assets in place of councils in return for a stream of revenues from developers and infrastructure users (including councils). We understand that the assets, or the revenue streams associated with those assets, could eventually be sold back to the relevant council or private investors.

To take this commitment forward, we would like to discuss with you:

- whether we have identified the right issues the Government is aiming to address
- the scope of the proposal, including whether it applies to bulk infrastructure and/or infrastructure within developments
- the role of Crown Infrastructure Partners, including the extent to which they can be used to address your objectives, and
- issues related to mechanics of the proposal for the use of bonds for secured lending, the use of targeted rates and other revenue streams and the ownership of assets and revenue streams.

While public capital has an important role to play, attracting greater third-party capital underpinned by revenue streams would also help to overcome current disincentives to investment facing current providers. Third-party capital refers to either financiers, community groups or iwi. This strategy is based on enabling new approaches towards financing and funding projects. This also means risks and costs involved are borne by the most appropriate sources, while infrastructure providers are able to get a sufficient return on their investment.

Another consideration is the role that new public and private approaches to infrastructure provision could play in enabling more housing-related infrastructure. New approaches could include more third parties bearing risks/debts for infrastructure provision in large, autonomous developments, or enabling greater central government involvement in areas of local government infrastructure provision.

We also note the New Zealand First Party's commitment to investigate the drivers of local government costs and their revenue bases, which may lead to new revenue streams for local authorities to fund infrastructure.

Relatedly, we note the Labour Party's policy to introduce a regional fuel tax to support Auckland's transport projects. We would welcome the chance to discuss Auckland funding options in more detail. A starting point may be the Auckland Transport Alignment Project (ATAP) report, which recommended increasing funding and targeting investment to the most significant challenges.

Lifting the performance of procurement

There are opportunities to lift the performance of how central and local government procures major infrastructure. A 2017 Infrastructure New Zealand survey shows that the industry rates 14% of the public sector's procurement expertise to be "good", 74% "average" and 12% "poor".

If improved procurement practices could create value of 5% to 10%, this would equate to $5.5 to $11 billion over the next 10 years. This dividend could be reinvested into other priorities.

Problems with current procurement practices include:

- lack of all-of-government thinking: opportunities for delivering infrastructure at a larger scale and utilising professional capability across the public system are often lost. This is partly enforced by a Vote and budget structure largely siloed by agency
- a poor understanding of whole-of-life costs, which can lead to cost blowouts
- varying levels of investment capability across government, and
- it is difficult to move resources from one project to the next, particularly between agencies.

Together with an increased focus on the planning of infrastructure investment, we have focused on improving the procurement and delivery of infrastructure. Changes made include the introduction of the Better Business Cases methodology to ensure that all capital investment is well considered and structured to effectively deliver improved outcomes.

In parallel, consideration has been given to how procurement processes can be used to improve the whole-of-life value for money of infrastructure investments. A key development in this area has been the adoption of performance-based procurement models where the Government only pays for infrastructure when it is delivering the desired outcomes.

One example of this approach is the Public Private Partnership (PPP) model, which bundles capital investment and asset management (and, in some instances, operations). This approach is more focused on outcomes and provides more consistent and predictable procurement processes together with a number of innovations in infrastructure design and asset management.

Finally, it is important that procurement decisions are made in the context of the objectives set down in the wider investment management system overseen by the Treasury.

Pressure Points That Require Attention

This section outlines the areas that we consider require particular attention over the next three years.

Managing Auckland's growth

Your government partners have stated they plan to invest heavily in Auckland's transport infrastructure as a way to improve the quality of life of Aucklanders and the economy of New Zealand's largest city. This particularly includes public transport investment which – as noted above – will be partly funded by a regional fuel tax. This is in response to the growth challenges that Auckland faces.

Auckland's ability to absorb growth has been reached. Environmental, housing and transport indicators all reflect a city under increasing pressure. Traditionally, Auckland has been more productive than other regions of New Zealand but, on a per capita basis, this productivity premium has been shrinking over time. Auckland is not performing as well as expected for its size and in comparison to other primary cities around the world. There are opportunities to increase this productivity but only if supply constraints, especially transport and housing, are resolved.

Addressing the supply constraints will require a holistic and strategic approach across government, local government and the private sector. Infrastructure investment processes risk following a business-as-usual approach and need to reflect more urgency and ability to deliver both at pace and a greater scale.

The Regional Development (Provincial Growth) Fund and improved regional rail network may complement Auckland's growth by providing good connectivity north and south and aligning land use planning and employment with the transport network.

As noted above, it is important that individual transport investments are supported by well-developed business cases. This is especially important in Auckland owing to the scale of the proposed investments and the opportunity cost associated with these.

ATAP has identified a 30-year package of $80 billion of investment required. With Auckland being fundamentally important to the long-run productivity of the national economy (75% of all growth in working-age population over the next 30 years is projected to be in Auckland) there is a very real risk that poor investment decisions will hard-wire a suboptimal Auckland transport network leading to a long-term drag on productivity.

Currently, congestion is increasing and travel times lengthening. It is important that transport investment decisions maximise the number of opportunities – jobs, education, services – each city resident can access. As with all infrastructure, these decisions need to work with land use planning to ensure best value for each dollar invested, make better use of existing networks, utilise new technologies and target investment where it will make the most difference at reasonable cost.

Three waters (drinking, storm- and wastewater)

As noted above, a lack of housing supply in high growth areas may also be driven in part by the slow pace of expansion of the three waters networks.

Previous New Zealand Infrastructure Plans state that the management, regulatory settings and governance for the distribution of New Zealand's water sector infrastructure requires the most attention in comparison to all other infrastructure sectors.

In recent years, there have been high profile failures in the three waters sector. These include substantial cost blowouts on wastewater schemes by the Kaipara and Whanganui District Councils and the failure of several parties (Hastings District Council, Hawke's Bay Regional Council and the Drinking Water Assessors) to adhere to the high levels of care and diligence necessary to protect public health for the Havelock North drinking water supply.

Barriers to adequate and responsive investment in three waters infrastructure include:

- a lack of consistent, reliable information on the state and performance of three waters assets and service delivery
- limits imposed by the Local Government Funding Agency on the ability for councils for borrow in order to fund asset renewals or make new investments

- a lack of specialised capability, particularly within smaller councils, to deliver modern water services, and
- political imperatives to keep rates low and a preference to prioritise civic infrastructure.

We recommend a review of the three waters sector that considers the performance of the financial incentives, asset management practices, monitoring and compliance and governance settings. These settings need to be improved so that local authorities can more easily respond to changes in demand and continue to meet acceptable water quality standards.

Improving the resilience of infrastructure

While recent earthquakes have shown the need for infrastructure to withstand shock events, there is a need for central government, local government and the private sector to increase the sophistication of how they think about resilience. This includes thinking more about interdependencies, levels of service and community preparedness. A longer-term view needs to be taken with increased focus on adapting to slower changes over time, including climate change. Importantly, increased resilience is not necessarily about making things stronger or investing more, and is quite often achieved by operational changes.

Asset management practices need to include a stronger understanding of the resilience of infrastructure networks at a national, regional and local level, especially key pinch-points and the degree to which different parts of networks are critical to overall performance.

We recognise the work underway by the National Lifelines Council, which has a mandate to enhance the connectivity of lifeline utility organisations across agencies and sector boundaries in order to improve infrastructure resilience. Our view is this work should continue.

Appendix 1: Framework for Responding to Future Challenges

As identified above, New Zealand faces challenges over the next 30 years which will mean we will not be able to continue building new infrastructure to meet demand. Instead, we need to better understand the services to deliver in the future, improve how we manage our existing assets and ensure we have the right settings to make better investment decisions in the future.

This is a more sophisticated approach to planning, developing and managing our infrastructure with an overriding focus on the outcomes we want to achieve, rather than the assets used to deliver them.

Increasing understanding of levels of service and future drivers of demand

The effectiveness of infrastructure depends on providers and funders understanding who they are catering for, and the services and quality levels they are providing. To become more effective we need to:

- take a “system” view of service delivery outside of any individual infrastructure
- better integrate land use planning at a national level, particularly the Resource Management, Local Government and Land Transport Management Acts (as outlined above), and
- have a clear and detailed vision that considers whole-of-life costs and aligns individual investment decisions with economic goals.

Strengthening asset management practices

This requires us to:

- get the incentives right: institutional incentives play a key part in achieving good asset management practice. For example, the fact that local authorities receive funding towards capital expenditure on roading from the NZ Transport Agency (NZTA) enables the NZTA to incentivise local authorities to adhere to a certain set of common standards and practices
- apply asset management capability wisely; for example, by managing some networks at the regional rather than the local level if doing so would allow skilled asset managers to apply their knowledge and capabilities more widely, and
- collect the right kind of data using shared data standards in a consistent and comparable way so that infrastructure condition and performance can be meaningfully compared and benchmarked.

Optimising decision making

This includes having the right governance and management structures in place, an effective regulatory regime and new ways of engaging with communities on decisions, levels of service and the trade-offs inherent in any decision. Optimised decision making requires us to strengthen:

- Governance and tools: We need to ensure that we have the right governance/ownership structures and it is clear where accountabilities lie and what outcomes are being sought or delivered.
- Demand management: We need to shift away from our traditional focus on building new infrastructure and first look at how existing assets might be better used through behaviour change; for example, New Zealand is fortunate to have the basis of a road pricing system to build on for the future.
- The regulatory system: We need to ensure that a predictable regulatory system provides businesses and people with the confidence to innovate, invest in capital, develop skills and take risks.
- Funding, financing and procurement: We need to consider the full range of tools when decisions are made to invest. This has been an area of focus with the Government Rules of Sourcing, efforts to build greater procurement capability in government and the availability of commercial experts to help government agencies with complex and significant procurements.

Appendix 2: National Infrastructure Advisory Board

The National Infrastructure Advisory Board's (NIAB) members are: John Rae (Chair), Margaret Devlin, Kathryn Edmonds, Edward Guy, Carl Hansen, Fiona Mules and Geoff Hunt.

NIAB was established in 2009 to help drive a step change to how infrastructure is delivered. The Board is made up of well-regarded representatives from across various streams of the infrastructure sector, including construction, finance, environmental management, local government, three waters and engineering.

NIAB is an advisory Board and has no statutory powers or responsibilities. The Board has up to five full-day meetings per year. In the past, the Chair has met with the Minister of Finance up to twice per year.

NIAB was established around the same time as the Treasury's National Infrastructure Unit (NIU). This model of having an infrastructure board supported by a unit was based on other jurisdictions, such as Australia and the UK.

The Board adds value by providing advice and acting as a sounding board for policy proposals to the NIU and Ministers based on their industry experience and regular liaison within the sector.

Having a substantial network also means the Board is in a position of influence within the sector and is well-placed to promote the strategy set out in the Plan. Given the Board's independence from government, it is also uniquely placed to lead the debate publicly on issues that may have political sensitivities.

Since its inception, NIAB has helped achieve the following:

- led the development of an evidence base for the existing performance of the sector to understand its performance against future needs
- led the development of a long-term vision for the sector, in partnership with local government and the private sector, through various Infrastructure Plans (the most recent being the Thirty-Year Infrastructure Plan 2015)
- influenced the sector to support the step-change outlined in the 2015 Plan so that the key elements of the framework outlined above are now common place, and
- involved in the early development of tools to improve the investment management system, such as the Better Business Case approach.

Appendix 3: Our Organisational Structure

Our teams and key contact information

DS Macro Economics and Growth	
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Director Growth and Public Services, Grace Campbell-Macdonald Teams: Business Growth & Innovation, Matthew Gilbert, Manager Regulatory Quality, Matthew Gilbert, Manager Economic Strategy & Productivity, Simon McLoughlin, Manager Education & Skills, Diana Cook, Manager Labour Market, Immigration & Tertiary, Kristie Carter, Acting Manager Natural Resources, Alastair Cameron, Acting Manager	Cell: +6421688094
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