The Treasury

Housing Infrastructure Fund
Information Release

Release Document

October 2016

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[1]	to prevent prejudice to the security or defence of New Zealand or the international relations of the government	6(a)
[4]	to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial	6(c)
[11]	to damage seriously the economy of New Zealand by disclosing prematurely decisions to change or continue government economic or financial policies relating to the entering into of overseas trade agreements.	6(e)(vi)
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[31]	to maintain the current constitutional conventions protecting collective and individual ministerial responsibility	9(2)(f)(ii)
[33]	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials	9(2)(f)(iv)
[34]	to maintain the effective conduct of public affairs through the free and frank expression of opinions	9(2)(g)(i)
[36]	to maintain legal professional privilege	9(2)(h)
[37]	to enable the Crown to carry out commercial activities without disadvantages or prejudice	9(2)(i)
[38]	to enable the Crown to negotiate without disadvantage or prejudice	9(2)(j)
[39]	to prevent the disclosure of official information for improper gain or improper advantage	9(2)(k)
[40]	Not in scope	

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Reference: T2016/1121 SH-3-2-18-16

Date: 16 June 2016

To: Minister of Finance (Hon Bill English)

Deadline: None
(if any)

Aide Memoire: Advice on infrastructure package

Treasury was asked for advice on:

1 Infrastructure funding options that do not include the Crown such as infrastructure that can be funded and/or built by the developer. What are the limitations on such arrangements currently and what are the constraints on them happening.
2 The development of an infrastructure fund that could be offered to high-growth councils to help with the upfront funding of infrastructure needed to enable greater housing supply without breaching the Councils' debt constraints. There are two main options:
   a. NZTA approach for roading infrastructure only
   b. CFH mechanism which could be used for other types of infrastructure

What constraints are we trying to overcome?
To ensure any intervention addresses the binding constraints we need to be clear what problem it is trying to solve. The core problem is that councils have been planning for and building infrastructure in a "just-in-time" basis. This is not consistent with encouraging competition in the market for development capacity. The surge in demand and the requirements of the National Policy Statement on Urban Development to make greater development capacity available have created both a short-term and a long-term challenge for councils/infrastructure providers. The short-term challenge is that the councils are operating at or near their debt constraints so cannot increase debt to finance the increased infrastructure capacity needed. Over the long-term the NPS is effectively asking councils to provide an amount of excess infrastructure capacity over and above what it has provided in the past. The costs of this excess capacity have not been built into current plans. Over the long-term councils will need to readjust their finances to ensure they have the revenue to cover those additional costs.

The proposed infrastructure fund is a way of helping overcome the council's short-term problem but does not help them address the longer term challenge of funding a greater level of excess capacity as this excess capacity will be needed on an on-going basis. Other mechanisms are needed to address that. Developers may help finance or fund that infrastructure but that is not the whole solution. Developers will be prepared to pay for the capacity their development will use but they will not be prepared to pay for the excess capacity created by building new headworks infrastructure needed to support a viable development market. Other revenue sources need to be found and/or ratepayers will be required to meet some of the costs.

More work is needed to deal with these longer term challenges. For example, the development of a structure under the proposed Urban Development legislation could help address some of these on-going challenges. The Productivity Commission report later this year should signal possible directions for change.

Question 1:

Developer agreements are permitted under s12 of the Local Government Act 2002 and are used frequently by developers and councils to enable the developer to provide and/or finance infrastructure provision ahead of when the council would otherwise provide/finance it.

Developers are only likely offer to fund local infrastructure upgrades or the cost of connecting to the existing network. See attached chart.

Developers are responsible for funding and constructing the in-sub-division infrastructure. Councils/infrastructure providers are responsible for funding the major upstream or headworks infrastructure. This is the large, expensive kit that services large areas like State Highways, water treatment plants etc. Developers are very unlikely to finance upgrades to those as they service urban areas much greater than any single development area.

Proposals by developers to fund local infrastructure upgrades are often welcomed by councils but in some circumstances they may not always be a good deal for the council. Some examples include:

- Where the developer is offering to pay the capital cost of the infrastructure but the council has not allowed for the higher operating cost that will be incurred as a result;
- The developer is only offering to pay for the local infrastructure and the development would trigger an upgrade to the more expensive bulk infrastructure which is not planned to occur until a later date;
- The developer is offering to build/finance/fund infrastructure needed for their own development when the efficient option would be to build infrastructure large enough to support surrounding land as well but the council has not allocated funding for the broader work.

In theory providing funding for one project shouldn't affect the amount available for other projects, but where there is a financing constraint, tradeoffs need to be made. If the council brings forward spending for one project, it may need to delay others.

Question 2:

The governance for any infrastructure fund needs to be commensurate with the amount being allocated. The Crown Fibre Holdings has high operating costs and is focused on addressing a specific risk, namely take-up of fibre by households. It is likely that a lower-cost mechanism may be appropriate in this case, depending on the scale of funding in question and the nature of the barrier to infrastructure development being overcome.

It is unlikely that we could nail down the details of such a mechanism in the next two weeks. We are happy to discuss how the Crown Fibre Holdings (CFH) model works and have some experts attending the meeting with you at 3:30pm this afternoon. However, in that case, the details of the exact structures used were worked out after bids from providers were received. We believe it prudent to work on the basis that the high level concept could be announced and the details worked out at a later stage.

We feel discussions with Councils are necessary to ensure the mechanism will meet their needs and this is not able to be done in the current timeframe. For example, the timing of the repayment could depend on when councils are likely to have headroom under their debt constraints. This will vary by council and we would be guessing if we tried to predict this without talking to them. Similarly, the accounting treatment can vary depending on the type of infrastructure provided.

There are some decisions about the overall structure that Ministers will need to make like the size of the fund and whether the loan is interest-free. These decisions along with decisions about timing of repayments will affect the overall cost to the Crown. You should note that if the loan is going to a party outside the Crown there will be an OBEGAL impact. We can talk through these details with you.

Despite that we have tried to be as specific as we can about how these mechanisms could work.

Given that we are talking about different types of infrastructure – potentially funded using different mechanisms, having a central governance framework would be beneficial. Councils could apply to "the fund" and applications could be allocated to the relevant experts for assessment. The fund could be structured as a maximum rather than an absolute amount. That process is already in place for roading via NZTA but would need to be created for other types of infrastructure.

[33]

[33]

a) NZTA funding arrangement

There are options for both funding and repayment where:

I. the Crown provides additional funding to NZTA; and

II. NZTA uses the additional funding to provide roading to enable housing.

III Council then repays NZTA via a lower Funding Assistance Rate in the out-years.

IV NZTA repays the Crown.

There are precedents for aspects of these processes. The Auckland Accelerated Motorway Package is an example of where NZTA has received additional funding to be directed to a specific purpose. The Matakana Link local roading acceleration proposal is an example of NZTA incurring the upfront funding for a specific project to ensure it is finished in time with another complementary project and in exchange Auckland Council acknowledges they will receive a lower funding rate in later years.

To create this process, an output agreement would be needed with NZTA which would specify the purpose to which the funding would be put. This could include guidance on factors that should be prioritised in allocating the funding, for example, housing. This may take several weeks or some months to conclude.

Treasury, Ministry of Transport and NZTA believe that an important criteria for Auckland would be the compatibility with ATAP which is due to produce its final report in August. Given the length of time that would be needed to set-up the process, we do not see this as a binding constraint.

The NZTA Board would need to be informed before announcement but this could be done outside of their normal meeting schedule. The Board will also need to consider the extent to which this proposal can be meet within NZTA’s own debt constraint. There is headroom in the near-term but once the Transmission Gully and Tuhoe projects are underway, that headroom is used up. So a process that enables repayment within that timeframe can be accommodated within existing parameters. Other changes may be needed if the timeframe goes beyond that.

Once projects had been identified, NZTA would enter into a Memorandum of Understanding with the respective council(s) about the effective repayment of the upfront costs. However, in the event that the council does not meet its obligations, NZTA has the power to withhold future funding. Though there is a risk that the council does not then fund the future roading that otherwise would have been built.

The quantum of the fund is a matter for discussion by Ministers. Ministers should note that the exact nature of the funding mechanism will determine whether it is capital or operating expenditure. Any NZTA transfer process could be operating or capital expenditure for the Crown depending on the nature of the project e.g. State highways would generally be classified as capital expenditure, whereas local roads are usually operating expenditure. If future Funding Assistance Rates to councils were reduced by the NZTA in such a way that allowed the NZTA to repay a loan from Crown within 10 years, it would not impact on net debt. If the funding from the loan is paid out as an operating grant with a corresponding reduction in expenses over the rest of the forecast period (current year plus the next four years), it would not affect the operating allowance either. Current capital allowances are $900 million per Budget or $3 billion across the forecast period. Operating allowances are $1.5 billion per Budget. Also be aware that any funding for the City Rail Link [33] also needs to be funded – most likely out of the operating allowance.

There is also a range of options around repayment by councils. These are likely to be council-specific. Auckland Council have said they have debt headroom in their forecast from early-mid 2020s.

b) Crown Fibre Holdings type arrangement

The basic concept of the Crown Fibre Holdings (CFH) arrangement is the creation of a special purpose vehicle (SPV) to purchase/hold/own infrastructure assets. The purchase would be funded by the Crown which would take effectively an equity stake in the SPV. The council would agree to repaying the cost of the asset as specified conditions are met.

The key elements of this proposal from the Crown’s perspective is that the SPV would have to own the assets otherwise it may be treated as a loan that would be counted against the councils’ debt covenants. The exact accounting treatment will depend on the specifics of the transaction including the nature of the infrastructure provided. The SPV would not have to be a separate entity and costs would be lower if the function was attached to an existing entity such as a Government department. We would need to identify an entity with similar objectives that could undertake the functions needed. Repurposing Crown Fibre Holdings is an option but as stated earlier this a high cost option that may be over-engineered for this purpose.

The exact structure and functions of the SPV would depend on the objectives. In the CFH case, the main objective was to shift the take-up risk away from providers to the Crown to facilitate competition for contracts by allowing other providers to compete on a “level playing field” with Telecom. Thus the repayment conditions depended on take-up of the broadband offering.

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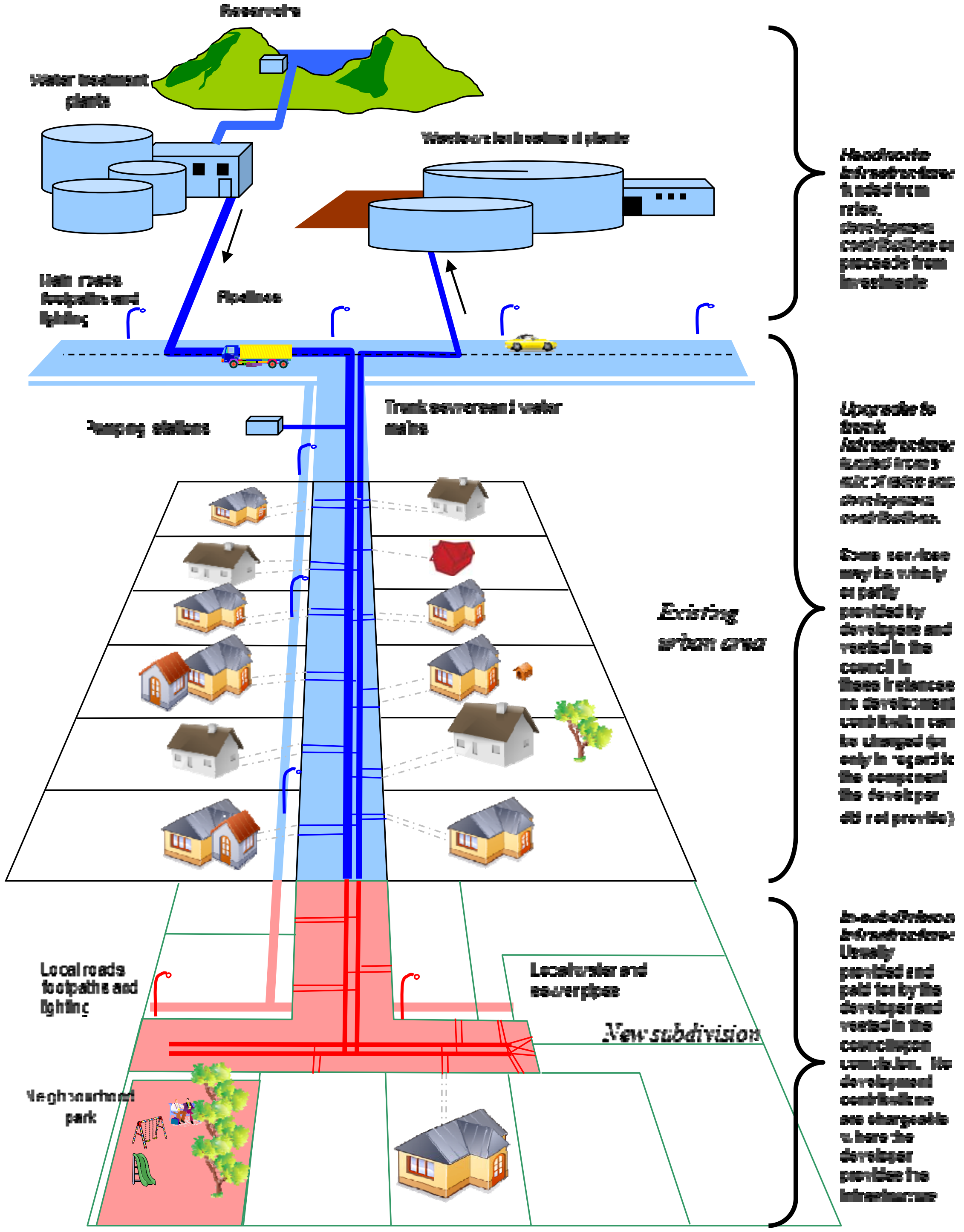

- Infrastructure provided by the developer is shown in shades of red
- Council provided infrastructure shown in shades of blue
- Private utility company (gas, electricity and telecommunications) not shown in this diagram