

## Treasury Report: Bilateral Briefing for Vote Finance

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<b>Date:</b>	29 February 2008	<b>Report No:</b>	T2008/276
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### Action Sought

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	Action Sought	Deadline
Minister of Finance (Hon Dr Michael Cullen)	<b>Read</b> the attached briefing before your bilateral with the Acting Minister of Finance	Meeting at 4.30p.m. on Wednesday 5 March 2008
Associate Minister of Finance (Hon Trevor Mallard)	<b>Read</b> the attached briefing before your bilateral with the Hon Dr Cullen	Meeting at 4.30p.m. on Wednesday 5 March 2008

### Contact for Telephone Discussion (if required)

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Name	Position	Telephone	1st Contact
Chris Bunny	Manager	<i>[deleted – privacy]</i>	✓
<i>[information deleted in order to protect the privacy of natural persons, including deceased people]</i>			

### Minister of Finance's Office Actions (if required)

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None
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**Enclosure:** Yes

## **Treasury Report: Bilateral Briefing for Vote Finance**

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Attached is a briefing for the Vote Finance bilateral to be held between yourself and Hon Trevor Mallard, as Acting Minister of Finance. The bilateral is to be held at 4:30 p.m. on Wednesday 5 March 2008.

Where the Minister of Finance is also the Vote Minister, Cabinet Office Guidelines (CO(02)17) require the Associate Minister(s) of Finance to take on the role of Finance Minister.

The bilateral briefing is structured as follows:

Recommendations	p. 4
Analysis of Vote	p. 7
One-page initiative summaries	p. 13

This bilateral covers the following six initiatives:

- ONTRACK Loans
- ONTRACK Equity Injection
- ONTRACK Wellington Network Upgrades; and
- GSF and NPF Annuitants Cost
- Hawkes Bay Airport Corporatisation
- Management of Crown Obligations for Geothermal Wells

Key issues for discussion are:

The Treasury recommends significantly scaling the capital proposal titled *ONTRACK Loans*. The proposed scaling is in line with the previous spending patterns by ONTRACK and assumes underspends will be transferred into the appropriation.

*[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

The Treasury does not support the proposal titled *GSF and NPF Annuitants Cost of Living Indexation*. We have recently advised you that this initiative is currently outside the Treasury's recommended "Other" package and that we do not consider that it represents value for money when compared to other initiatives in the "Other" package. The initiative is fully scalable. You have indicated that full funding is your preferred option.

## Recommended Action

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We recommend that you **read** the attached briefing and use it as the basis for making decisions in your bilateral with the Acting Minister of Finance at 4:30 p.m. on Wednesday 5 March 2008.

**Chris Bunny**  
for Secretary to the Treasury

**Hon Dr Michael Cullen**  
Minister of Finance

## Recommendations

### VOTE FINANCE

#### a ONTRACK Loans

analysis p. 7

- The initiative seeks Crown loans to ONTRACK in 2008/09 only. The loans would be at market rates and used to fund: 1) renewals of the tracks; and 2) land release costs.
- The Treasury recommends significantly reducing the loan from that initially sought to \$90 million in 2008/09. The proposed amount is based on scaling of the proposed activities reflecting previous years' expenditure patterns. The \$90 million would be funded from \$40.155 million of savings in 2007/08, \$25 million of savings in 2008/09 and \$24.845 million of new capital from Budget 2008.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 &amp; Outyears</i>
<i>Capital (GST excl)</i>					
Funding sought	(28.005)	212.400	-	-	-
Treasury		90.000	-	-	-
Treasury proposed savings	(40.155)	(25.000)			

#### b ONTRACK Equity Injection

analysis p. 8

- This initiative is to provide \$10 million equity to ONTRACK to fund the purchase of Wellington Railway Station from the Crown.
- The Treasury supports the initiative. The purchase is fiscally neutral.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 &amp; Outyears</i>
<i>Capital (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

**c ONTRACK Wellington Network Upgrades**

**analysis p. 9**

*[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

**d GSF and NPF Annuitants Cost of Living Indexation**

**analysis p. 9**

- The initiative ensures that all GSF and NPF annuitants are treated consistently by receiving 100% of the CPI as a cost of living adjustment.
- This proposal was submitted in Budget 2007 but did not receive funding. The Treasury's view is that the proposal does not represent value for money when compared to other initiatives in the "Other" package.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 &amp; Outyears</i>
<i>Operating (GST excl)</i>					
Department	-	-	33.200	-	-
Treasury	-	-	-	-	-

**e Hawkes Bay Airport Corporatisation**

**analysis p. 10**

- The proposal seeks an appropriation of \$8.0 million for the corporatisation of Hawkes Bay airport. Corporatisation will clarify the ownership of the airport and allow it to operate more independently.
- The Treasury supports the initiative. The purchase is fiscally neutral as the transaction reflects a change in the form of an entity and the assets already sit on the Crown's balance sheet.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 &amp; Outyears</i>
<i>Capital (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

**f Management of Crown Obligations for Geothermal Wells**

**analysis p. 10**

- The department seeks of *[information deleted in order to enable the Crown to carry out commercial activities without disadvantage or prejudice]* for cleanup work required on redundant geothermal assets at Wairakei. Some of these assets are owned by the Crown and others belong to Contact. The Crown indemnified Contact for liabilities relating to redundant assets that Contact purchased in 1998.
- The Treasury supports the initiative. This is fiscally neutral and will be funded from savings within Vote Finance: Other Expenses Incurred by the Crown – Crown Residual Liabilities.
- Whilst it is envisaged the work will be carried out in 2007/08, this depends on reaching agreement with Contact. Provision should be made for an in-principle transfer of part or all of the funding to 2008/09 to take account of this possibility.

	<i>\$million - increase/(decrease)</i>				
	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 &amp; Outyears</i>
<i>Operating (GST excl)</i>					
Department	-	-	-	-	-
Treasury	-	-	-	-	-

## Vote Finance – Analysis

### Analysis of Initiatives

- Funding is being sought for Vote Finance through this bilateral and also through themes Economic Transformation and National Identity. This is summarised in the table below:

	<i>\$million - increase/(decrease)</i>				
<i>Funding sought for Vote Finance in Budget 2008</i>	<i>2007/08</i>	<i>2008/09</i>	<i>2009/10</i>	<i>2010/11</i>	<i>2011/12 &amp; Outyears</i>
<i>Operating (GST excl)</i>					
At this bilateral	-	-	33.200	-	-
Through Theme Economic Transformation	35.143	30.330	4.123	3.323	2.823
Through Theme National Identity	0.585	-	-	-	-
<b>TOTAL OPERATING</b>	<b>35.728</b>	<b>30.330</b>	<b>37.323</b>	<b>3.323</b>	<b>2.823</b>
<b>TOTAL CAPITAL</b>	<b>(28.005)</b>	<b>212.4</b>	<b>58.0</b>	<b>30.0</b>	<b>30.0</b>

- None of the capital initiatives discussed in this bilateral have a related operating component being sought through the Themes process.

### **ONTRACK Loans** (recommendation a)

- ONTRACK is seeking \$212.4 million in commercial loans in 2008/09 through the Debt Management Office for renewals and upgrades of the track, land release and various commercial projects. This is a regular appropriation which is provided on a year-on-year basis.
- The Treasury considers that this initiative is necessary for ONTRACK to maintain the rail network, but that the funding provided for ONTRACK Loans should be scaled based on past spending patterns (options for scaling are discussed in paragraph 6 below) and utilising savings and existing appropriations.
- Specifically, the Treasury recommends providing a total of \$90 million for ONTRACK Loans, including \$24.845 million of new capital funding from Budget 2008. The recommended funding split is set out in the table below and detail is provided in paragraph 10.

<i>Funding source</i>	<i>\$M</i>
2007/08 ONTRACK Loans underspend	38.005
2007/08 ONTRACK Equity underspend	2.150
2008/09 National Network Upgrades appropriation (not allocated to any projects yet)	25.000

Budget 2008 capital	24.845
<b>TOTAL</b>	<b>90.000</b>

6. ONTRACK has a number of capital projects putting pressure on rail resources which will take priority over standard upgrade and renewal work in 2008/09. In previous years the funding provided for renewals and upgrades has not been exhausted. Options for scaling loans are detailed below.

	<i>\$ million</i>			
	ONTRACK sought	Treasury option	Budget 2007 provided	Expected spend for 2007/08
Renewals	80.000	60.000	70.005	66.400
Upgrades	66.000	0	n/a*	n/a*
Land release	46.400	30.000	38.000	13.600
Commercial projects	20.000	0	20.000 contingency	0
<b>TOTAL</b>	<b>212.400</b>	<b>90.000</b>	<b>108.005</b>	<b>80.000</b>

\* in 2007/08 upgrades are still being funded from the \$200 million grant provided under the NRAA. The MYA is set to finish at the end of 2007/08 but is likely to be underspent.

7. ONTRACK forecasts that the existing upgrades grant provided under the NRAA will be under spent in 2007/08 by approximately \$30 million. This funding will be transferred into 2008/09 meaning no loan provision needs to be made for upgrades based on the past ability to spend upgrade funding. ONTRACK expects to spend a total of \$23 million on upgrades in 2007/08.
8. The loan allocation for renewals has been scaled back to \$60 million based on past spend and the increased work programme ONTRACK faces in 2008/09. The Treasury does not view loans for commercial projects as necessary.
9. ONTRACK expects that there will be more land release activity in 2008/09 than there has been in 2007/08. If a decision was made to slow down land release discussions with Toll NZ then the initiative could be scaled further. However, Treasury recommends some funding should be allowed for land release in 2008/09 due to the uncertainty in the rail industry.
10. Treasury has recommended taking \$40.155 million savings from 2007/08 (in accordance with ONTRACK forecasts) and \$25 million existing funding in 2008/09 to help fund ONTRACK Loans. The savings are larger than originally put forward by ONTRACK because it has recently reforecast its underspends. In Budget 2007, \$25 million was provided in each of 2008/09 and 2009/10 for non-standard upgrades of the national network. The funding was dependent on a business case. ONTRACK has yet to begin work on a business case for this funding and has not incorporated the spending into future projections. Treasury proposes moving the 2008/09 funding into ONTRACK Loans *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*.

#### **ONTRACK Equity Injection (recommendation b)**

11. The department seeks \$10 million for an equity injection to ONTRACK to allow ONTRACK to purchase the Wellington Railway Station from the Crown. \$20 million has already been allocated in previous Budgets but the recent renovations have meant the value of the station has increased.



12. Treasury supports this initiative as it is fiscally neutral. The transaction will be the trade of a Crown asset (the Wellington Station) for increased equity in a state owned enterprise (ONTRACK).

***Wellington Network Upgrades (recommendation c)***

*[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

***GSF and NPF Annuitants Cost of Living Indexation (recommendation d)***

13. Currently around 17,000 or 30% of all GSF and 2,100 or 40% of NPF annuitants receive between 90 and 100% of the CPI as an annual cost of living adjustment to their GSF pensions. This initiative proposes that all annuitants receive 100% of the CPI as a cost of living adjustment.
14. The Treasury does not consider that the proposal represents value for money compared to other initiatives in the “Other” package. We do note however that while the fiscal impact is \$31.8 million in 2009/10 only, the demand impact is just \$4 million per year as annuitants spend their extra benefit.

15. The initiative is fully scalable. In order to reduce the cost of the initiative, either or both of the cost of living adjustment level or the cohort of annuitants benefiting from the initiative would need to decrease. For example, if both NPF and GSF move to 95% indexation, the cost would reduce to \$11.5 million. However, even at this reduced cost, we do not consider the proposal represents value for money.

#### ***Hawkes Bay Airport Corporatisation (recommendation e)***

16. An appropriation of \$8.0 million is sought for the corporatisation of Hawkes Bay airport. The airport entity was valued at \$10.1 million in November 2007, of which the Crown owns 50%. The proposed appropriation is larger than 50% of the valuation to allow a contingency for any revaluation prior to corporatisation. Currently the Crown's interest in the joint venture airport sits on the Ministry of Transport's balance sheet. When the new company is formed it will need to purchase these assets from the Crown and the Crown will need to purchase 50% of the equity in the new company.
17. The project team is aiming to have a Heads of Agreement signed between Cabinet and the Councils in April 2008 with the corporatisation to happen in July 2008. This means that the appropriation for the transaction needs to be in place before July.
18. Treasury supports this initiative as it is fiscally neutral.

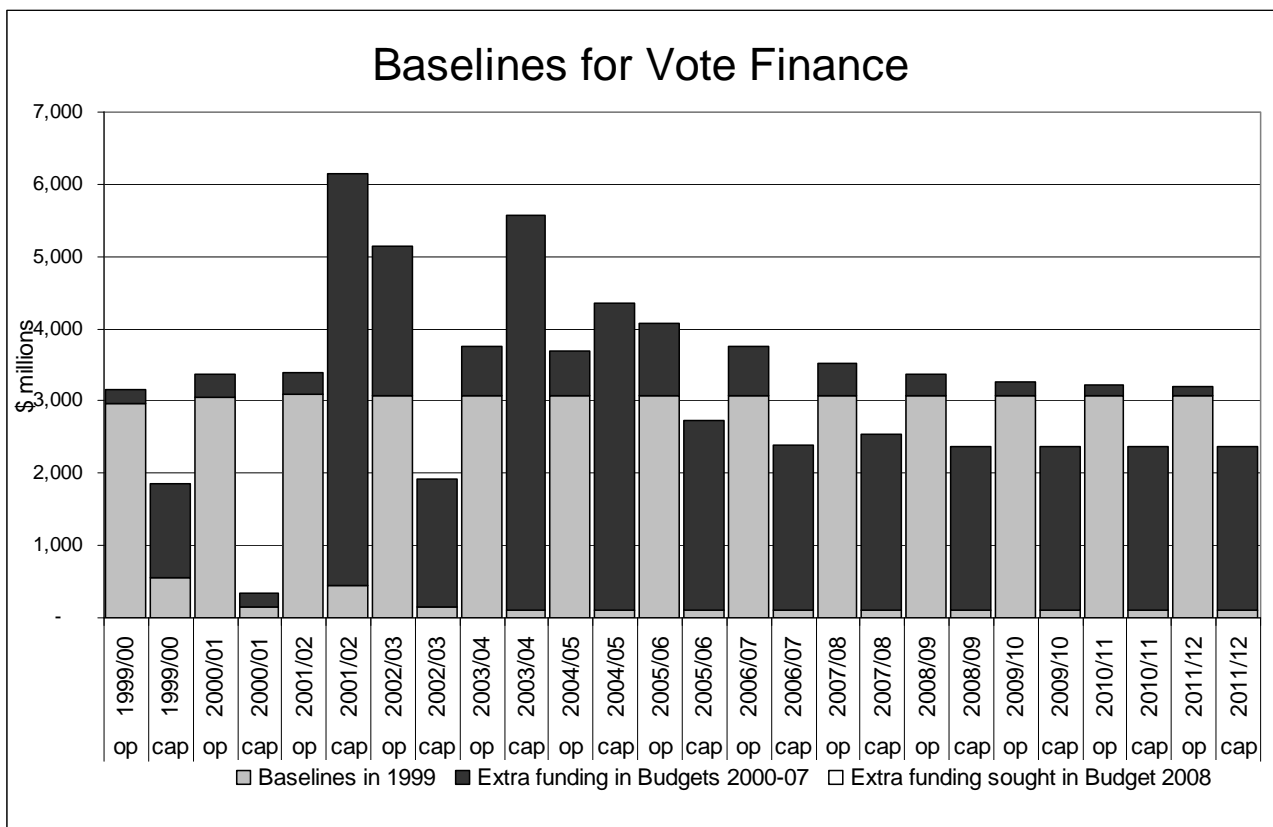
#### ***Management of Crown Obligation for Geothermal Wells (recommendation f)***

19. An appropriation of *[information deleted in order to enable the Crown to carry out commercial activities without disadvantage or prejudice]* is sought for cleanup work required on redundant geothermal assets at Wairakei. Some of these assets are owned by the Crown and others belong to Contact. The Crown indemnified Contact for liabilities relating to redundant assets that Contact purchased in 1998. The Treasury supports this initiative.
20. *[information deleted in order to enable the Crown to carry out commercial activities without disadvantage or prejudice]* However, some additional remedial work may also be required once some of the landfill sites have been demarcated. The initiative is fiscally neutral as the costs will be funded from savings in Vote Finance: Other Expenses Incurred by the Crown – Crown Residual Liabilities.
21. Whilst it is envisaged the work will be carried out in 2007/08, this depends on reaching agreement with Contact. Provision should be made for an in-principle transfer of part or all of the funding to 2008/09 to take account of this possibility.

#### **Analysis of Vote Finance**

22. Vote Finance baselines are currently \$6,060 million. This includes \$57 million in departmental output classes, around \$2,400 million for capital contributions to other persons or organisations (the majority of which is for contributions by the Crown to the NZ Superannuation Fund) and \$2,100 million for debt servicing.
23. The Vote has received significant increases in recent years. These increases have primarily been within appropriations for Other Crown Expenses and Capital Contributions to other organisations, and include:
  - In 2002/03 and 2003/04 equity injections to the University of Auckland to assist in funding a proposed Business School;

- In 2002/03 and 2003/04, appropriations to recapitalise Television New Zealand as a Crown company under its own legislation, and subsequently to capitalise its subsidiary company Transmission Holdings Ltd as a stand-alone SOE;
- In 2003/04 and 2004/05 capital investment in Track Co;
- In 2004/05 a capital injection into the Reserve Bank;
- In 2004/05 and 2006/07 loans to NZRC and Ontrack;
- the Government's annual contribution to the New Zealand Superannuation Fund;
- In 2006/07 and 2007/08 appropriations for ONTRACK operating and maintenance, upgrades and renewals of the National Network, Auckland and Wellington passenger networks;
- In 2007/08 a loan to Wellington Regional Council to upgrade rail passenger services.

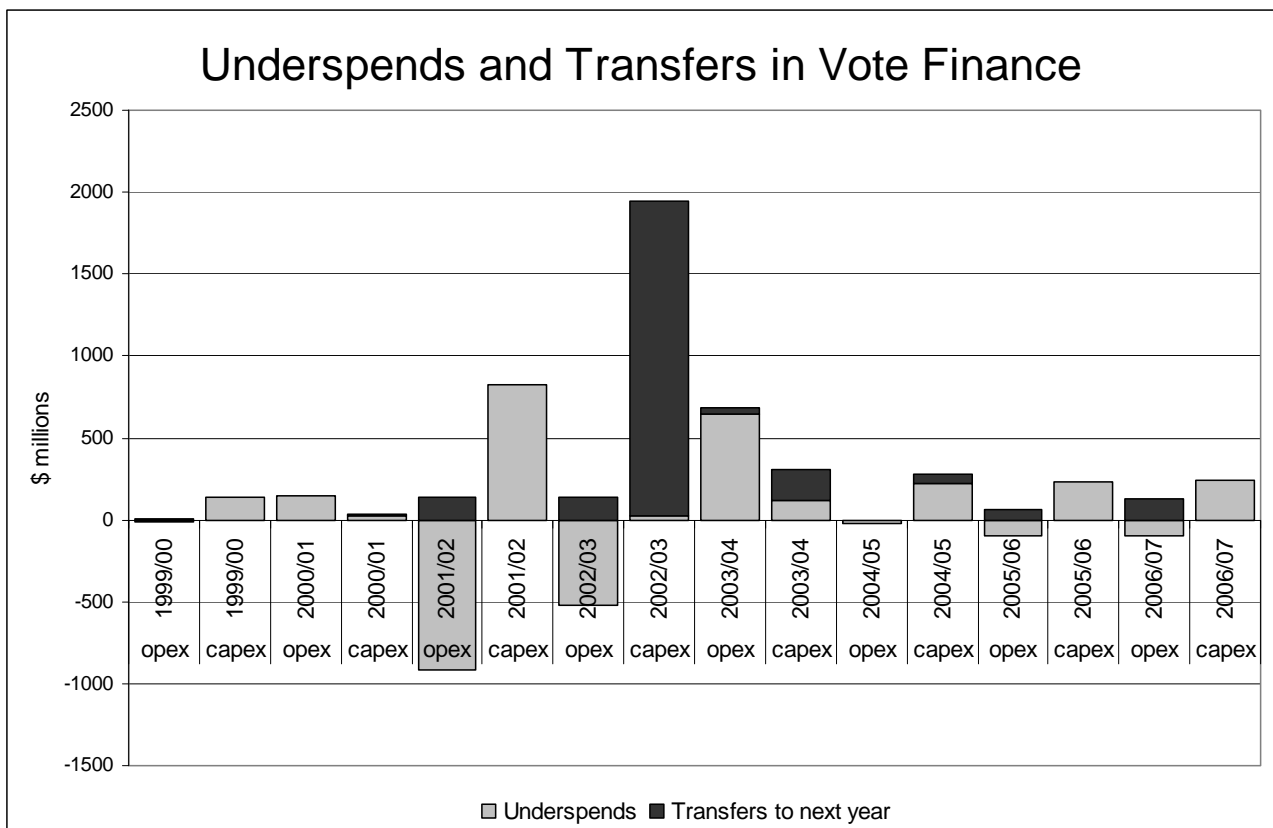


24. Over recent years departmental baselines have been largely static. There has been a history of small underspends within departmental baselines with savings being returned to the Crown. The significant underspends within the Vote have tended to occur within appropriations for Other Crown Expenses and also Capital Contributions. These underspends have generally been outside the control of the department and include:

- In 2004/05, 2005/06 and 2006/07, a capital underspend of \$200 million in each year as New Zealand did not receive or pay any calls for share subscriptions under their membership in International Financial Institutions (IFI's).
- In 2005/06, an additional capital underspend was due to a delay in the Crown's \$20 million investment in Rugby World Cup 2011 Ltd. Overspends of operating expenditure were due to actual NZDMO borrowing costs and the Crown's contribution to Government Superannuation Fund being greater than forecast by \$127 million. Underspends in operating expenses reforecast and transferred into the 2006/07 year were a result of a reduction in the drawdown of gas under the Maui

Contract of \$29 million, and payments to ONTRACK for Auckland Rail Development and the Upgrade of Rail Network multi-year appropriation being \$35.4 million less than forecast.

- In 2006/07 additional capital underspends were mainly for delays in calls by ONTRACK for Loans and Equity Injections of \$32.6 million. Overspends of operating expenditure were due to actual NZDMO borrowing costs and the Crown's contribution to Government Superannuation Fund being greater than forecast by \$62 million. Operating underspends were a result of payments to ONTRACK for the Auckland Rail Development Multi-Year appropriations being \$77 million less than forecast. This was partially offset by additional payments made under the Upgrade of Rail Network multi-year appropriation.



## One-page Initiative Summaries

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One-page summaries of the initiatives for discussion at this bilateral are attached on subsequent pages.