

Treasury Report: Budget 2008: Bilateral for Capital Initiatives in Vote Corrections and Vote Customs (China FTA Initiative)

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|--------------|------------------|-------------------|-----------|
| Date: | 29 February 2008 | Report No: | T2008/303 |
|--------------|------------------|-------------------|-----------|

Action Sought

| | Action Sought | Deadline |
|---|---|--|
| Minister of Finance (Hon Dr Michael Cullen) | Read before the Bilateral with Hon Phil Goff | Before 3.30pm on Wednesday 4 th March 2008. |
| Associate Minister of Finance (Hon Trevor Mallard) | Read before the Bilateral with Hon Phil Goff | Before 3.30pm on Wednesday 4 th March 2008. |

Contact for Telephone Discussion (if required)

| Name | Position | Telephone | 1st Contact |
|--|---------------------------------------|----------------------------|--------------------|
| <i>[information deleted in order to protect the privacy of natural persons, including deceased people]</i> | | | |
| Rowena Phair | Manager, Justice and Asset Management | <i>[deleted – privacy]</i> | |

Minister of Finance's Office Actions (if required)

| |
|-------|
| None. |
|-------|

Enclosure: Yes

**Treasury Report: Budget 2008: Bilateral for Capital Initiatives in
Vote Corrections and a Vote Customs China
FTA Initiative**

Attached is a briefing for the bilateral between the Minister of Finance and Hon Phil Goff at 3.30 p.m. on 4 March 2008 to discuss the capital initiatives in Vote Corrections and a Vote Customs China Free Trade Agreement initiative.

The bilateral briefing is structured as follows:

| | |
|-------------------------------------|-------|
| Vote Corrections | |
| Recommendations | p. 3 |
| Analysis by Vote | p. 8 |
| Customs China FTA Initiative | |
| Recommendations | p. 7 |
| Analysis by Vote | p. 16 |
| One-page initiative summaries | p. 18 |

We expect the key issues for discussion will be:

- Capital sought for the replacement of Mt Eden Prison
- Capital sought for Corrections' Capacity Management Programme

Recommended Action

We recommend that you **read** the attached briefing and use it as the basis for making decisions in your bilateral with Hon Phil Goff at 3.30p.m. on 4 March 2008.

Rowena Phair

Manager, Justice and Asset Management
for Secretary to the Treasury

Hon Dr Michael Cullen

Minister of Finance

Recommendations

VOTE CORRECTIONS

a Mt Eden Replacement

analysis p. 8

- The Department seeks *[deleted – confidentiality of advice]* million capital to decommission the obsolete Mt Eden Prison and construct 450 replacement beds on the existing site. The Department's view is that the replacement is a necessary precursor for any potential future expansion of the site. The Department is self-funding \$106 million of the capital cost.
- Treasury's view is that this initiative should be deferred for the following reasons:
 - *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
 - While there is a certain level of risk around service failure at Mt Eden, Treasury has seen no evidence over the past year to suggest that this risk has worsened since Budget 2007.

| | <i>\$million - increase/(decrease)</i> | | | | |
|---------------------------|--|----------------|----------------|----------------|-------------------------------|
| | <i>2007/08</i> | <i>2008/09</i> | <i>2009/10</i> | <i>2010/11</i> | <i>2011/12 & Outyears</i> |
| <i>Capital (GST excl)</i> | | | | | |
| Department | <i>[deleted – confidentiality of advice]</i> | | | | |
| Treasury | - | - | - | - | - |

If funding is approved for the Mt Eden Replacement then **Treasury Recommendation:**

| | <i>\$million - increase/(decrease)</i> | | | | |
|---|--|----------------|----------------|----------------|-------------------------------|
| | <i>2007/08</i> | <i>2008/09</i> | <i>2009/10</i> | <i>2010/11</i> | <i>2011/12 & Outyears</i> |
| <i>Capital (GST excl)</i> | | | | | |
| <i>[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]</i> | | | | | |

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

b Capacity Management Programme

analysis p. 10

- The Department seeks *[deleted – confidentiality of advice]* million capital to: *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
 - build additional capacity for the Community Probation and Psychological Service as a result of increased offender volumes;
- Treasury supports capital funding for infrastructure to support increased volumes of offenders in the Community Probation and Psychological Service, subject to the operating funding being supported through the Families – Young and Old theme.

| | <i>\$million - increase/(decrease)</i> | | | | |
|---------------------------|--|----------------|----------------|----------------|-------------------------------|
| | <i>2007/08</i> | <i>2008/09</i> | <i>2009/10</i> | <i>2010/11</i> | <i>2011/12 & Outyears</i> |
| <i>Capital (GST excl)</i> | | | | | |
| Department | <i>[deleted – confidentiality of advice]</i> | | | | |
| Treasury | - | 23.847 | - | - | - |

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

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

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

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

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

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

VOTE CUSTOMS

h Interagency Resource Needs for Trade Agreements

analysis p. 16

- Customs is seeking funding in contingency for a certificate of origin database, depending on decisions about government or private sector ownership of the database, to support implementation of the China Free Trade Agreement.
- Treasury's view is that Customs should fund the capital cost of this initiative from its balance sheet if Ministers agree to government ownership under Customs' charge. Customs' forecast cash available for capital at 2007/08 year end is \$5.783 million.
- Treasury understands Customs would like to retain cash reserves to fund other initiatives and business-as-usual requirements. However, the cash reserves are not sufficient to fund an upcoming large initiative (Border Management System), which will require a capital injection anyway.

| | <i>\$million - increase/(decrease)</i> | | | | |
|---------------------------|--|----------------|----------------|----------------|----------------|
| | <i>2007/08</i> | <i>2008/09</i> | <i>2009/10</i> | <i>2010/11</i> | <i>2011/12</i> |
| <i>Capital (GST excl)</i> | | | | | |
| Department (contingency) | - | 0.500 | - | - | - |
| Treasury | - | - | - | - | - |

Vote Corrections – Analysis

Analysis of Initiatives

1. Funding is being sought for Vote Corrections through this bilateral and also through the Families – Young and Old theme. This is summarised in the table below:

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

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

Mt Eden replacement (recommendation a)

3. The Department seeks *[deleted – confidentiality of advice]* capital to decommission Mt Eden Prison and construct 450 replacement beds on the existing site as agreed by Cabinet in 2004. At this time, five strategic options for the future of Mt Eden were presented by the Department. Cabinet agreed to the Department's preferred and lowest cost option. At Treasury's request, the Department then prepared an *Analysis of Strategic and Master Planning Design Options* paper in early 2007, which re-enforced that the option agreed to by Cabinet was the most cost-effective option for the site.
4. The design of the site has been completed to the 90% stage and the main construction contractor has been appointed after a competitive tender process. Capital funding sought in Budget 2008 is for the following:
 - the construction of replacement accommodation to allow the decommissioning of Mt Eden;
 - the construction of support facilities and infrastructure required for the future development of the site; and
 - the preservation and conversion of the Mt Eden Prison heritage building for ongoing staff and administration use.
5. Mt Eden Prison is over 120 years old and is no longer operationally efficient, which has led to higher costs of operation. The facility's non-compliance with legislation and penal regulations means it carries a number of risks to the health and safety of staff, visitors and prisoners. The Joyce Group report undertaken in 2004 concluded that there was a high probability of service failure at Mt Eden Prison.

6. If there was a large scale disruption at Mt Eden and the facility had to be closed, the Department would need to utilise its disaster recovery beds. However, the Department expects that it will need to utilise some of its disaster recovery capacity from 2009 to meet demand in response to the revised 2007 Justice Sector Prison Population Forecast. Therefore, this capacity would not be available from 2009/10 in the event that Mt Eden had to be closed.
7. Treasury does not support the replacement of Mt Eden at this point in time. The replacement of Mt Eden does not add to capacity, and will actually remove approximately 90 beds from the prison system from mid 2008 to mid 2011.

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

8. While the Department states that deferral of the replacement of Mt Eden will increase the risk of service failure, Treasury has not seen any evidence to suggest that the situation has worsened since Budget 2007.
9. Treasury recommends that the need to replace Mt Eden be appraised as part of Corrections' wider Capacity Management Programme. This appraisal may lead to revisiting alternative strategic options previously considered, such as constructing additional capacity on the Mt Eden site without decommissioning the existing facility. Treasury acknowledges that the Department investigated 5 strategic options for the Mt Eden site in 2004, and that Cabinet agreed to the option presented in this bid. We also acknowledge the Department's current view that this option remains the most cost-effective for the site. However, although this may be the optimal option for the site when it is considered in isolation, it may not be when considered in the context of *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*
10. The Department's view is that if this bid is not approved, their Capacity Management Programme will be more expensive, deliver capacity south of Auckland (leaving a shortfall of beds in the Auckland region) and will not be able to meet demand in time. This is because *[deleted – confidentiality of advice]* of the *[deleted – confidentiality of advice]* additional beds discussed in the Capacity Management Programme bid are at Mt Eden Prison. Based on the Department's preferred strategic option for the site, these beds can only be added after the Mt Eden replacement programme has been completed. If the bid is approved in subsequent budget rounds escalation costs of at least 3-4% per annum would also be incurred by the Department.

Broadleaf Capital Quantitative Risk Analysis

11. In 2007, Treasury commissioned Broadleaf Capital to undertake quantitative risk analysis of the Mt Eden replacement project. This analysis placed the mean value of the project's capital cost at \$216.3 million, *[deleted – confidentiality of advice]*. Should Ministers wish to fund this project in Budget 2008, Treasury recommends that the Department receives approval for expenditure at Broadleaf Capital's mean value of \$216.3 million. *[deleted – confidentiality of advice]*.

CAPACITY MANAGEMENT PROGRAMME *[deleted – confidentiality of advice]*

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

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

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

Capacity Management Programme *(recommendation b)*

15. The Department seeks *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*. The capital funding required for this initiative is aimed at providing sufficient capacity to meet the Forecast by:
[deleted – confidentiality of advice]
 - recruiting an additional 90 Probation Officers (and purchase of associated infrastructure) as a result of increased Community Probation & Psychological Services offender volumes.

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

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

18. Based on the mix of current offender “new starts” (not including the consequences of the draft 2007 Prison Population Forecast), Corrections requires a further 90 Probation Officers to restore and maintain the current volume of “new starts”. *[information deleted in order to*

avoid prejudicing the maintenance of law] It is more cost effective to expand the capacity of the probation service than for extra offenders to be incarcerated. The capital component of this bid is for the purchase of infrastructure to support the additional Probation Officers.

19. *Department of Corrections assessment of the risks of not funding this initiative:*

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

[information deleted in order to avoid prejudicing the maintenance of law]

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

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

22. Treasury considers that there are merits in additional funding for infrastructure to support the increase in Community Probation and Psychological Services offender volumes. We support this component of the Capacity Management bid, provided that operating funding is supported through the Families – Young and Old theme.

[deleted – confidentiality of advice] (recommendation c)

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

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

[deleted – confidentiality of advice] (recommendation d)

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

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

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

[deleted – confidentiality of advice] (recommendation e)

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

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

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

[deleted – confidentiality of advice] (recommendation f)

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

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

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

[deleted – confidentiality of advice] (recommendation g)

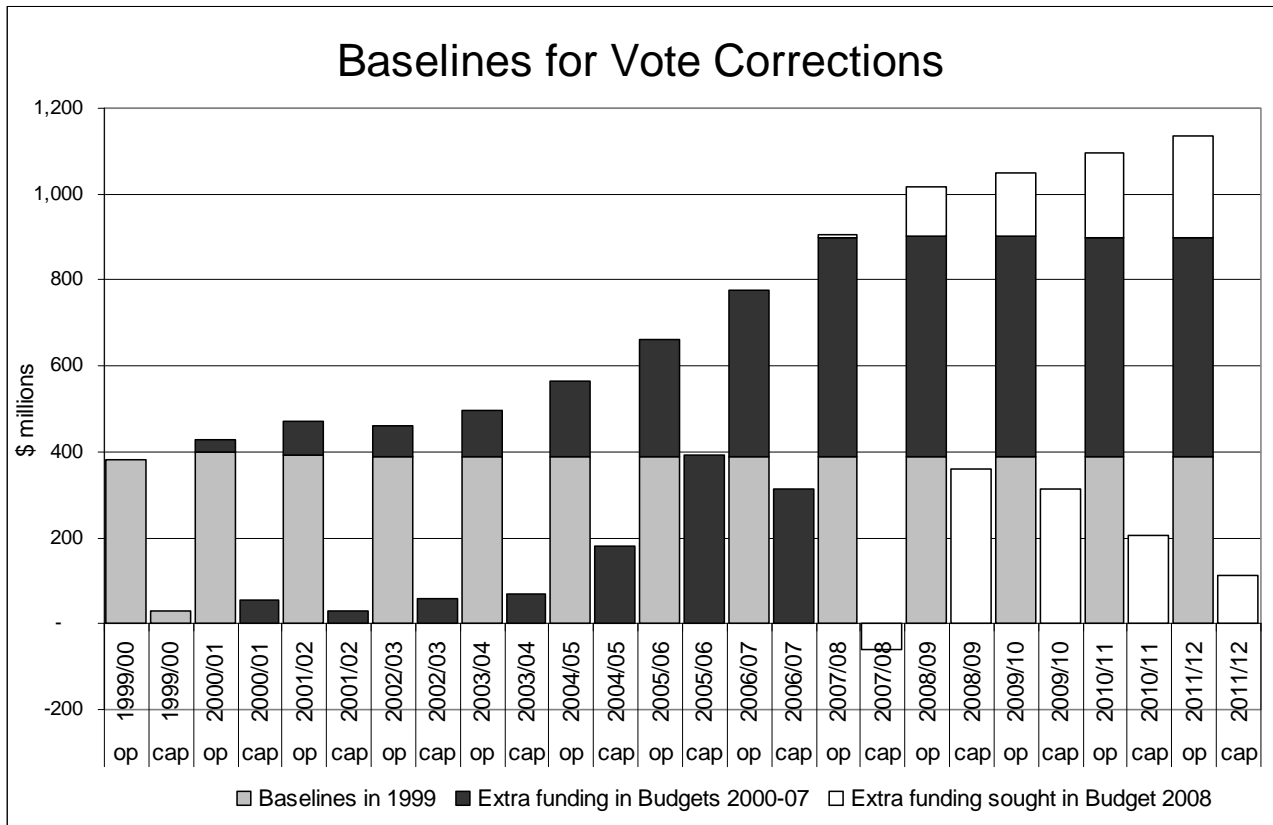
34. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

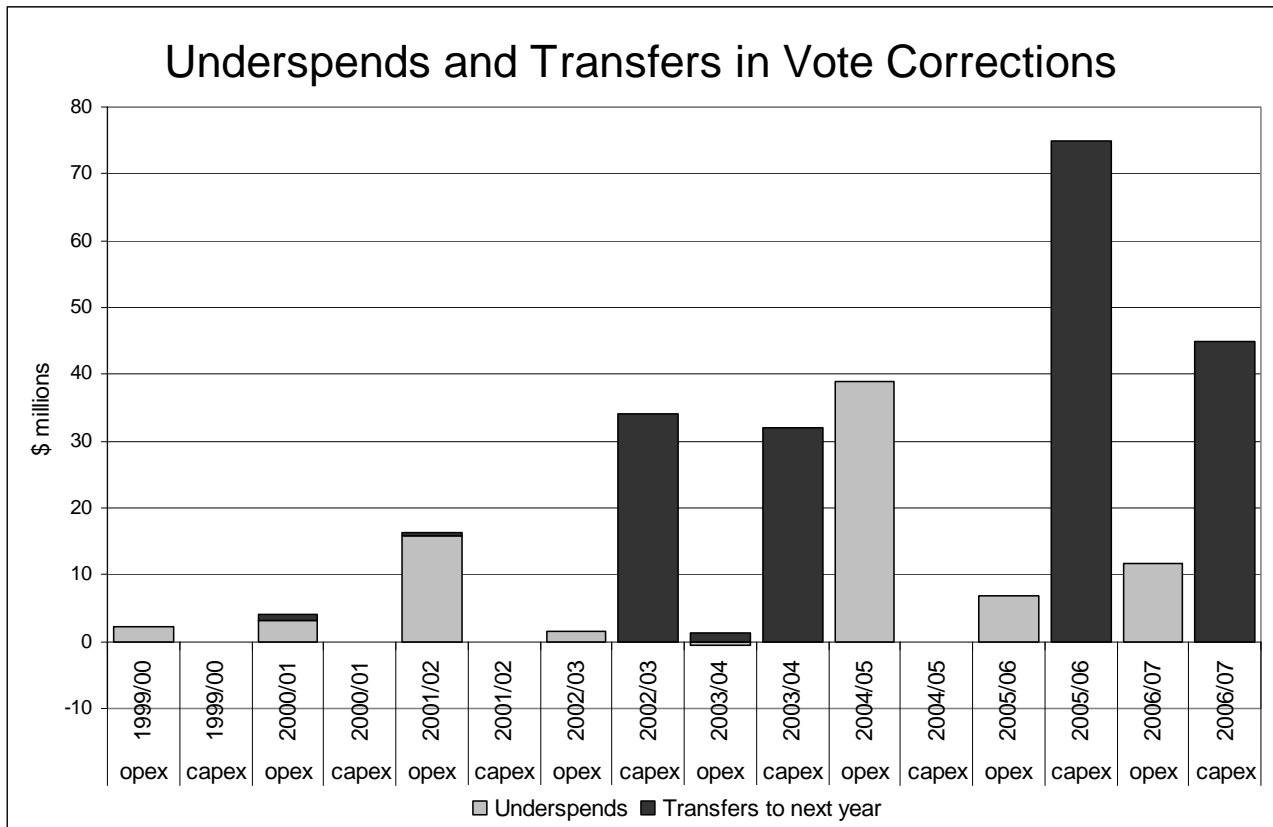
35. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials]*

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

Analysis of Vote

37. Vote Corrections baselines are shown in the graph below. The majority of the increases were related to the Output Pricing Review (2003), bargaining round funding, Effective Interventions and funding for new facilities (both new sites and building on existing sites). This funding was made up not only of operational costs but also depreciation and capital charge. This also included funding for disaster recovery utilisation.





38. The transfer of \$75 million capital from 2005/06 to 2006/07 reflected a revised spending profile on some deferred maintenance and the infrastructure associated with the Department's 493 bed programme which was approved in 2004. The revised schedule was required to prioritise the construction of additional cells.

39. The transfer of \$45 million capital from 2006/07 to 2007/08 reflected a revised spending profile on some infrastructure associated with the 493 bed programme approved in 2004 and Effective Interventions Home Detention programme appropriated in 2006. This deferral was due to delays in the master planning process.

Vote Customs – Analysis

Analysis of Initiatives

40. Funding is being sought for the capital component of a Vote Customs initiative through this bilateral relating to the China Free Trade Agreement. Funding for Vote Customs is also to be considered in your bilateral with Hon Nanaia Mahuta, and through the Economic Transformation theme. This is summarised in the table below:

| | <i>\$million - increase/(decrease)</i> | | | | |
|---|--|----------------|----------------|----------------|-------------------------------|
| <i>Funding sought for Vote Customs in Budget 2008</i> | <i>2007/08</i> | <i>2008/09</i> | <i>2009/10</i> | <i>2010/11</i> | <i>2011/12 & Outyears</i> |
| <i>Operating (GST excl)</i> | | | | | |
| At this bilateral | - | - | - | - | - |
| Through Economic Transformation Theme | <i>[deleted – confidentiality of advice]</i> | | | | |
| TOTAL OPERATING | <i>[deleted – confidentiality of advice]</i> | | | | |
| <i>Capital (GST excl)</i> | | | | | |
| At this bilateral | - | 0.500 | - | - | - |
| At Hon Nanaia Mahuta' s bilateral | <i>[deleted – confidentiality of advice]</i> | | | | |
| TOTAL CAPITAL | <i>[deleted – confidentiality of advice]</i> | | | | |

41. *[deleted – confidentiality of advice]*

Interagency Resource Needs for Trade Agreements (recommendation h)

42. Customs is seeking funding in contingency for a certificate of origin database to support implementation of the China Free Trade Agreement. The need for funding is contingent on decisions about government or private sector ownership of the database.
43. Treasury expects the benefits of the China Free Trade Agreement to more than outweigh the combined implementation costs. However, should a decision be made for government ownership (and Ministers agree that Customs be charged with operating the database) Treasury is of the view that Customs should fund the capital cost from its balance sheet given the fiscal constraint in Budget 2008. Customs' forecast cash available for capital at 2007/08 year end is \$5.783 million.
44. The operating costs associated with this initiative in 2008/09 are supported within the Economic Transformation theme. *[information deleted in order to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and*

officials]

45. Customs notes that capital funding for the database will be required if government owns the database, whether or not the Crown or third party fee payers meet the consequential operating costs.
46. While Customs have sufficient cash on hand to meet the capital cost of this initiative, there is insufficient cash to also meet other high priority initiatives in Customs' portfolio (e.g. Customs Border Management Systems Replacement Programme), and a capital injection will be required sometime in the near future.

Analysis of Vote

47. Customs' forecast cash available for capital at 2007/08 year end is \$5.783 million. This balance when added to forecast future depreciation flows and the requirement to manage working capital and existing infrastructure replacement, does not enable Customs to fund the upcoming border management system replacement programme from within current cash reserves and out year cash flows. Commitments to other new initiatives from existing cash reserves effectively increase the capital injection requirements when the border system replacement decisions are made.

One-page Initiative Summaries

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