The Treasury

Budget 2018 Information Release

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THE TREASURY
Kaitohutohu Kaupapa Rawa

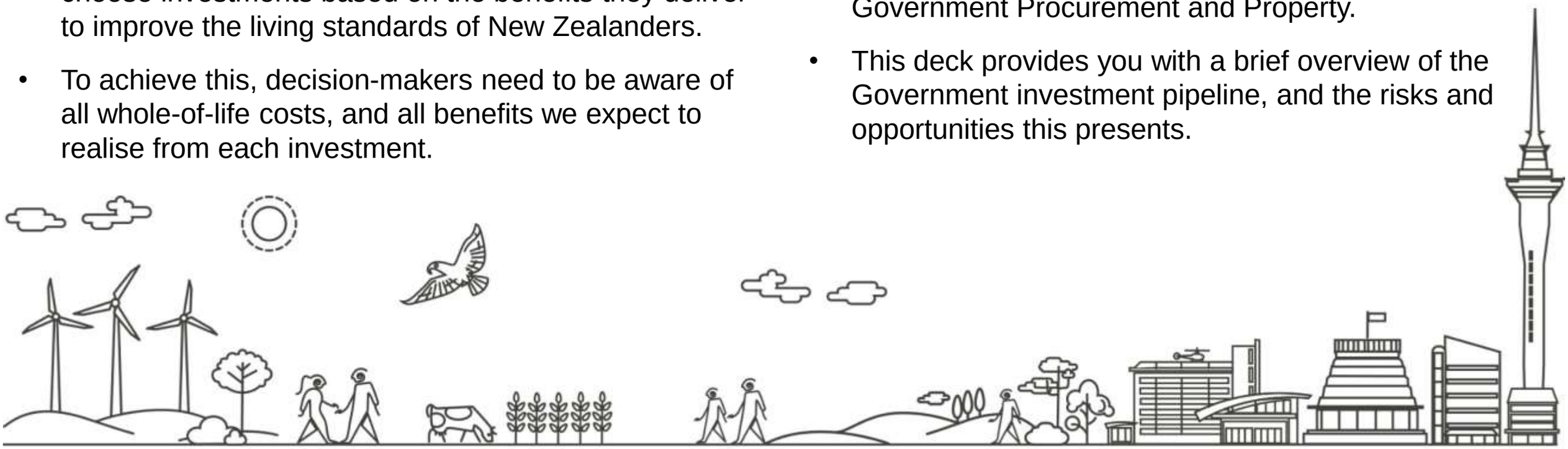
Introduction to Government investment for the Minister of Health

Budget-sensitive

December 2017

Introduction

- Government investment commits resources in anticipation of future benefits – to do things like help New Zealanders connect, learn, get jobs, commute, grow businesses, stay safe and live healthy lives.
- There are always more good ideas and opportunities for investment than there are resources to pursue them.
- Effective investment management is important to make sure investments deliver as expected, while conserving resources so other opportunities can be pursued.
- You have indicated that the Government wishes to choose investments based on the benefits they deliver to improve the living standards of New Zealanders.
- To achieve this, decision-makers need to be aware of all whole-of-life costs, and all benefits we expect to realise from each investment.
- Investments then need to be assessed relative to others across Government, making use of regional, sectoral, and category-based (such as ICT and Infrastructure) perspectives help to inform difficult trade-offs.
- To do this, you will make use of the processes, rules, capabilities, information and behaviours which we refer to collectively as the investment management system.
- The Treasury is your lead advisor on investment, and we partner with others with key roles in the investment system, notably the State Services Commission, the Government Chief Digital Office and New Zealand Government Procurement and Property.
- This deck provides you with a brief overview of the Government investment pipeline, and the risks and opportunities this presents.



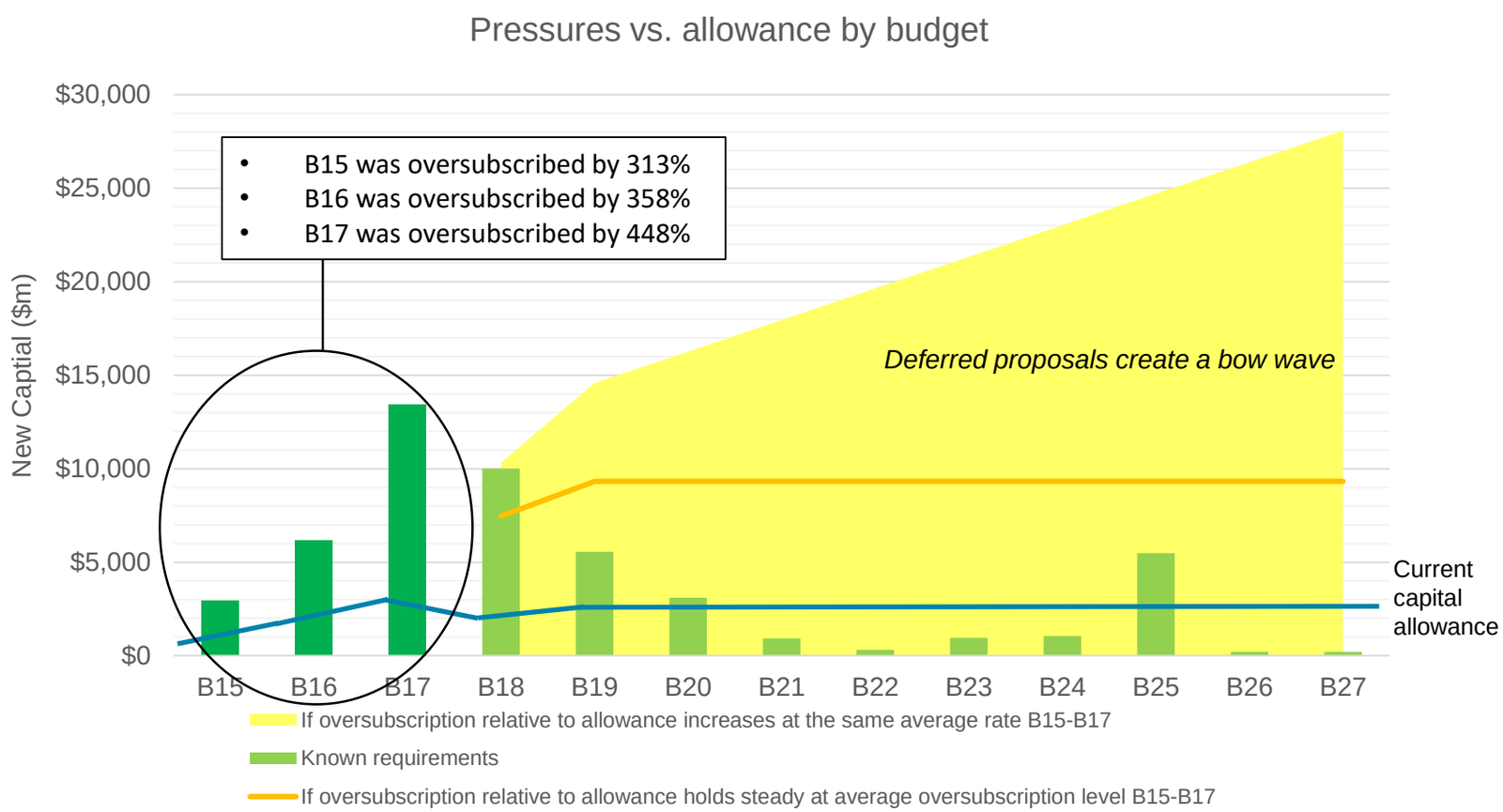
The investment pipeline

What is the investment pipeline?

- The pipeline shows our current understanding of new crown capital requests across a 10 year horizon.
- We have collated information on the investment pipeline since 2015, based on information provided by agencies.
- The pipeline tends to be 50-70% accurate in the near term (within the next 12 months) at predicting the new capital required.

There is pressure on the Capital allowance

- Over the last few years the budget has been consistently oversubscribed (more opportunities than funding)
- The further out we go, the less visibility we have (with the exception of Defence investment). We expect that budgets that appear undersubscribed will become oversubscribed in time.



Key drivers of current pressures

- Post-war infrastructure (such as hospitals) that is near end-of-life and ICT capability that is no longer fit-for-purpose – especially when depreciation has been repurposed and spent on other initiatives
- policy settings of the previous Government (notably OPEX constraints)
- unfunded proposals come back for funding later (due to non-discretionary investment)
- population and/or demand pressure

Potential pressures not currently accounted for in the pipeline:

- Auckland Light Rail ~$5b (tbc)
- Waitangi museum ~$100m (tbc)
- Kiwibuild: initial capital funding allocation will be established through Budget 18, quantum tbc
- [33]
- Prison capacity: policy to increase police numbers may have a flow on effect for prisons, requiring investment to increase prison capacity

The investment essentials

Capital allowances and your Fiscal Strategy

- Table 1 sets out the capital allowances agreed to in the Budget 2018 and Fiscal Strategy Cabinet paper, consistent with the Government's Fiscal Strategy.
- The first row in Table 1 includes capital pre-commitments: City Rail Link, Crown Infrastructure Partners and NZ house. The second row has the pre-commitments taken out to illustrate the unallocated capital allowance amount.
- The capital allowances exclude contributions to KiwiBuild and NZSF and tagged contingencies (e.g. Waikeria Prison contingency).

Table 1: Budget 2018 – 2021 Capital allowances ($ millions)

($ million)	2018	2019	2020	2021	Total
Capital before pre-commitments	3,400	3,400	3,100	2,700	12,600
Capital after pre-commitments	2,632	2,672	2,672	2,700	10,676

How capital allowances are counted?

- Capital investment reflects the net impact of the project over the next ten years against one allowance. Unlike the operating allowance, capital is a one off injection.
- It is in addition to depreciation funded projects which is already included in departmental baselines and reflected in the Economic and Fiscal Updates for each sector.
- The capital charge and depreciation funding associated with these projects is managed against the operating allowance.

How do we reflect both cash profile and commitments?

- The full commitment is 'counted' against the single year Budget capital allowance. The cash profile of investments and forecast future capital allowances are reflected in the forecasts.
- Items are included in Economic and Fiscal forecasts if it can be quantified with reasonable certainty and if is reasonably probable the item will eventuate.

We are aware of the following issues with this approach and will provide further advice:

- Counting significant investments against single year capital allowances.
- Capital related operating expenditure (capital charge and depreciation funding).
- Levels of capital asset management and devolved decision making in the investment system.

Investment pipeline risks and opportunities

Risks

- The volume of projected investment isn't affordable within current capital settings
- The volume of investment is likely to strain capacity within Government, which means investments are more likely to fail or deliver fewer benefits than expected
- The volume of projected investment is already constrained by market capacity – to continue investment we need to develop the market or attract international suppliers to participate

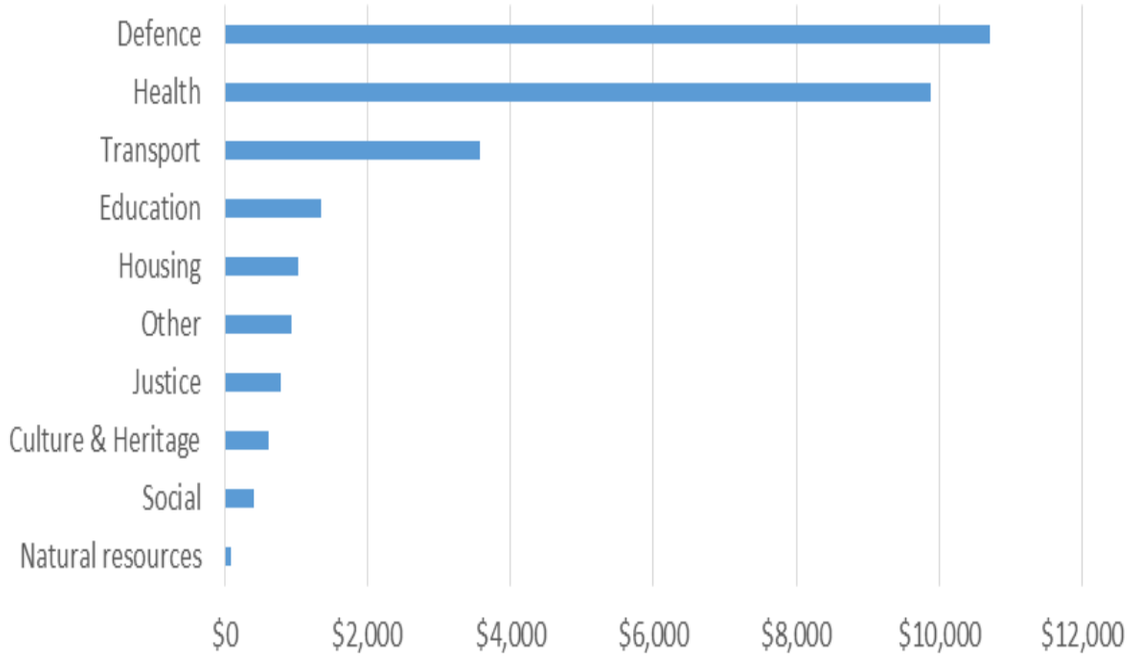
Opportunities

- Early – and longer term – commitments to investment could provide sufficient market confidence for the market to grow (for example in construction)
- This could help drive employment and provide sustainable apprenticeship opportunities
- A better understanding of long-term needs could provide for countercyclical investment, allowing the Government to make the most of a slow-down from other investors – and help businesses retain staff

Collaboration will be critical to succeed

- Mitigating these risks and making the most of these opportunities will require discussion and alignment across multiple portfolios
- Health and Defence sectors dominate capital requirements across the ten year horizon, but trade-offs need to be across government and not just within sectors
- The leads for categories and functions have a key role in investment, including the Government Chief Digital Office, New Zealand Government Procurement and Property within MBIE and the Treasury

Known new capital intentions ($m) by sector to 2027



Health investment

DHBs own and manage most public health assets

- Property, Plant and Equipment: $6.3B
- Other assets (ICT): $535M
- Ministry of Health holds mostly ICT assets: $49M

DHB balance sheets are weak: cash and investments total $330M across 20 DHBs, including five in overdraft. Depreciation, which has not always been funded, is often used for new investment. Most major investments are now primarily or fully funded by new Crown capital.

Ministry of Health role in hospital developments has expanded

Since 2012, major investments have been planned and delivered by Ministry-managed “Partnership Groups” (Christchurch, Grey, Dunedin). The intent of this approach is to provide capability for once-in-a-generation projects and to build expertise that can be transferred between projects.

This model also provides independent governance and direct reporting to the Ministers of Health and Finance, which provides greater alignment with expectations.

Major investments provide a unique opportunity to modernize and improve service delivery so that new facilities are the right size and fit-for-purpose

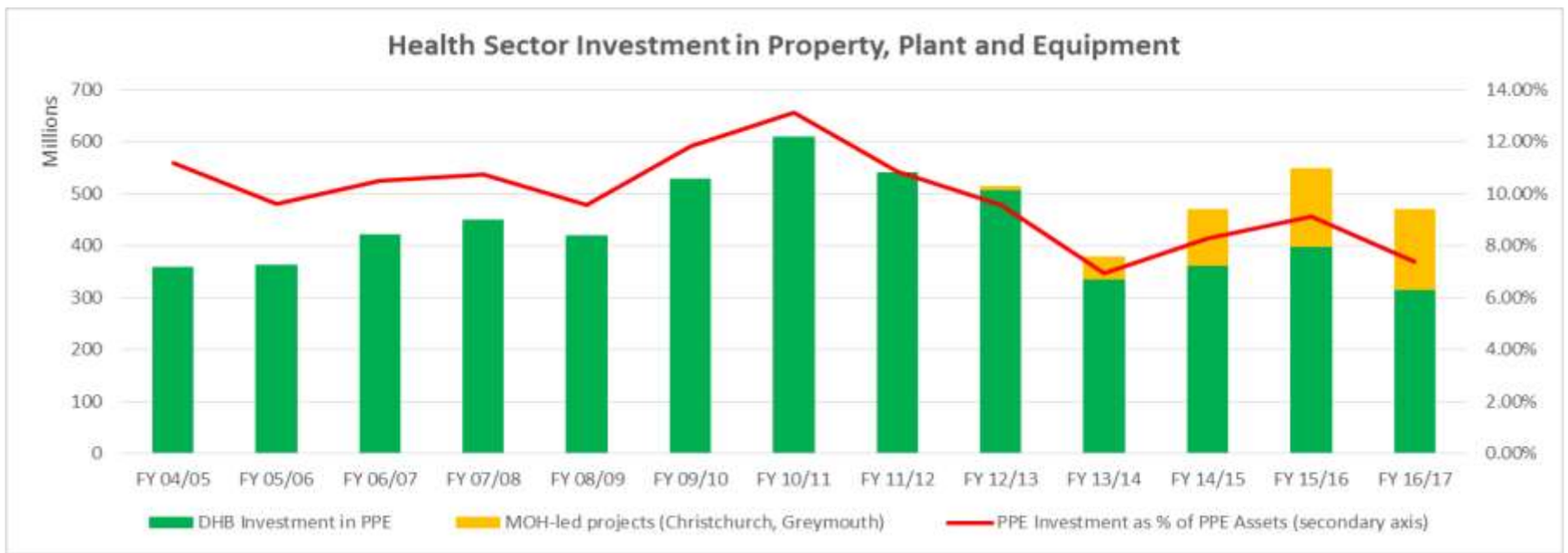
Service planning is a pre-cursor to any investment, ideally with a focus on models of care that reduce demand for hospital services, but are generally limited to DHB specific changes that do not challenge regional or national service provision. Business cases may also identify investment in different assets (workforce, ICT) to deliver outcomes.

Investments can result in smaller facilities in absolute terms (Grey Hospital), but generally the aim is to design new facilities that are smaller than they would otherwise be if models of care did not change.

Backlog of investment in the system post-Christchurch rebuild

Asset age and condition, fitness-for-purpose and demographic growth (particularly in the Northern region) are major drivers for redevelopment.

There are currently over 30 business cases under development across the sector that would require Ministerial approval if they progress.



Health Investment

Decision-making for DHB investments

DHB Boards make decisions on baseline (depreciation) funded investments up to $10M in value. Under delegation from Cabinet, Joint Ministers of Health and Finance approve business cases over $10M or where new Crown funding is required.

- Advice is provided from, the Ministry of Health, the Treasury, and the independent Capital Investment Committee (CIC) – established under 2010 reforms.
- New Crown funding is allocated from non-departmental capital appropriations – the Health Capital Envelope (HCE) – for which funding is sought annually through the Budget process.
- Use of the Treasury Better Business Case (BBC) model is a requirement for all investment proposals.
- Cabinet approval is needed for major investments where funding exceeding the HCE is required (e.g., Dunedin).

Decision-making for Ministry of Health Investments

Ministry of Health investments are primarily in information technology which provide national level data infrastructure and support national services. Major projects require Cabinet approval and funding. The Treasury and other Central Agencies provide advice to Ministers and Cabinet on the quality of investment proposals and monitor the progress of major investments.

Investor Confidence Ratings

Treasury investor confidence ratings (ICR) cover eight investment intensive DHBs and Ministry of Health. The spread of ICR results in the health sector is similar to other government agencies and DHBs have similar strengths and weaknesses. However, major investments were largely excluded from the analysis and there are significant questions about the scalability of the capability identified.

Review of DHB capital settings and performance

The Ministry of Health and Treasury have undertaken a number of initiatives with DHBs to enhance visibility of capital asset management and update system settings over the past 4 years.

- The **asset management maturity** of DHB facility portfolios was reviewed, uncovering significant maturity gaps. As a result the Health Asset Management Improvement (HAMI) group was established to share best practice. However, HAMI has struggled to deliver gains due to resourcing issues.
- Visibility of the **health capital pipeline** is an ongoing challenge given DHBs' short-term planning horizons, weak asset management plans, and a reluctance to disclose. In 2016, regional capital plans were replaced with a requirement for long term investment plans (LTIPs). A national-level compilation of these plans is underway, but data quality is variable and largely reflects a bottom up view of investment needs.
- An initiative to **restructure DHB balance sheets** was completed in early 2017, replacing Crown debt with equity. This removed a financing model which was not achieving anticipated benefits and distorted decision-making, but the conversion exposed underlying capital affordability challenges that had been partially obscured through debt financing.

Organisation	ICR Rating	Score/100
Counties-Manukau	A	82
Waitemata	B	72
Auckland	B	71
Canterbury	B	69
Northland	C	61
Waikato	C	57
Capital & Coast	C	51
Southern	In progress	
Ministry of Health	C	62

Upcoming Decisions

Pressure on Health Capital Envelope (HCE)

In Budget 17, $150M was appropriated to the HCE, which at the time had appropriated funding remaining from Budget 14 of $121M. There is $185M of unallocated funding in the HCE for the remainder of FY 17/18.

- Allocations since Budget 17 have been in response to project cost pressures (Christchurch ASB, Dunedin urgent works), poor condition asset renewal (Middlemore hospital ward re-cladding, Tanekaha Unit replacement), and funding the planning for Dunedin Hospital.

New Crown capital funding requests from DHBs which are anticipated to be submitted in FY 17/18 are likely to exceed the available funding, requiring deferral, scaling and prioritization options to be considered. The potential HCE allocation in Budget 18 and anticipated pressures in FY18/19 will also need to be taken into account.

- Recommendations on prioritization should be sought from officials and the Capital Investment Committee before further significant investment decisions are made.

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Ministry of Health business cases

Two major Ministry of Health business cases are under development:

- The national bowel screening programme IT system business case, which is required to draw down a tagged contingency established in Budget 16. This business case is now anticipated to be delivered in June 2018 (pending Cabinet agreement to extend the contingency).
- The indicative business case (IBC) for the national Electronic Health Record (eHR). Cabinet endorsement would be needed to progress this initiative to the detailed business case stage (DBC), which would provide the basis for a future Budget bid.

Budget 18

The Ministry is signalling DHB capital pressures of $2.6B in Budget 18 based on bottom up view of capital intentions.

[33]

- Readiness and relative priority of business cases needs to be challenged – primarily related to northern region capacity and remediation projects.
- Assumes carry over of FY 17/18 pressures rather than re-prioritization.

[33]

Health Investment Pipeline

10 year DHB Capital Pipeline

A national-level view of the capital investment pipeline has been under development by the Ministry over the past year. This work has revealed:

- DHB Capital intentions of $14B with $9.2B of new Crown capital.

Generally, the data received from DHBs changes frequently, is of variable quality and has a facility-dominated, short-term bias. This is evident from the bow wave of expenditure and the drop off in capital demand outside the northern region in out-years. There is also a lack of realism about planning and delivery timeframes.

However, the combination of information gleaned from the northern region LTIP, the Dunedin rebuild and other projects where we have visibility confirm the scale of the challenge.

Asset age and condition is a major issue across the sector but the extent is yet to be fully surfaced. Demographic growth is also driving demand. Stabilization/de-risking, technological change and consumer expectations are driving ICT investment.

Northern Region Long-term Investment Plan (LTIP)

The Northern Region LTIP provides regional view of investment pressures across the Auckland-metro (and Northland) DHBs over the next 15 to 20 years. This represents the first true regional service and capital plan and has not yet been replicated in other regions.

The investment demand is largely in response to asset condition (18% of assets in poor/very poor condition), growth (hospitals are currently at capacity with 562,000 more people expected in 20 years), and increasing complexity of service demand.

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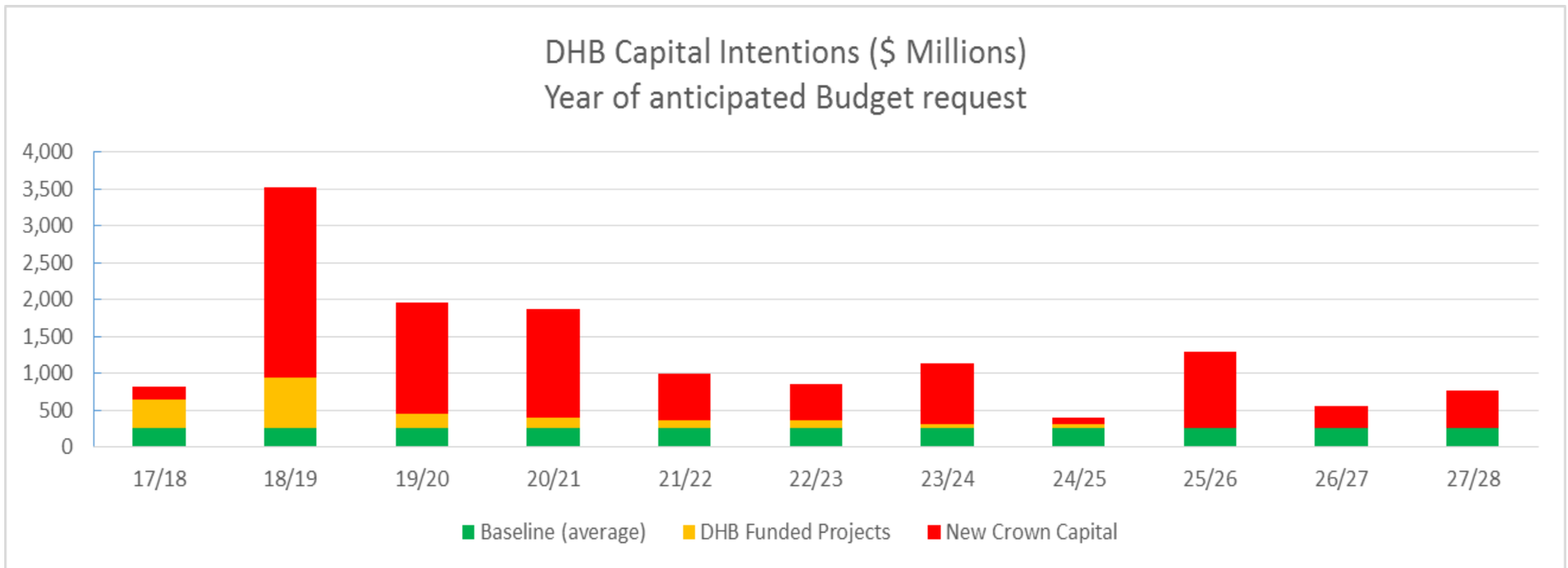

Health Investment Policy Challenges

Service planning

Problem: Regional and national service planning is largely non-existent.

In the absence of a clear view of what services are optimally and appropriately delivered at a national, regional and local level, ad hoc arrangements pre-dominate and preclude the development of a national asset management plan (AMP). The development of a national AMP was intended in the 2010 Ministerial review group reforms to inform the work of the CIC, but never progressed.

Response: Develop framework for national, regional and local service planning/delivery to inform investment decisions.

Portfolio Management

Problem: Lack of effective portfolio management.

ICR results identify significant gaps in DHB and Ministry portfolio management maturity that will take several years to remedy.

No effective framework in place to prioritize investment and understand trade offs. Limited visibility of DHB intentions and low confidence in most local planning capacity and capability. Lack of standards for asset condition and functionality to inform investment needs.

The current 'run to failure' model of hospital replacement (e.g. Dunedin, Greymouth) carries high risks of service failure and limits options for the Crown.

Response: More effective portfolio management is critical to provide confidence to Cabinet that the right investments are being made and that they are deliverable, cost-effective, achieving anticipated benefits, and are managed well over the long-term.

Hospital Planning and Construction

Problem: Significant capacity and capability constraints in the planning, design and construction of hospitals limit the delivery of the health investment pipeline under current settings.

- A small pool of sector expertise and DHB-led investment results in cost increases and a heavy dependence on a consultants.
- Boutique service and facility design reflects local preferences rather than agreed standards and best practice.

Response: Ministry Partnership Group model for centralizing planning and procurement of "once-in-a-generation" developments is unsustainable as structured and not scalable to meet demand. The funding, entity form and operating/governance model require urgent review before additional projects are undertaken, including whether this function should be health specific or part of multi-sectoral approach.

There is an opportunity to build a centre of excellence to support the health sector to plan and build for the future using a standardized approach.

Capital Affordability

Problem: The capital pipeline is not affordable in terms of the quantum of investment signalled or the resulting ongoing operating costs.

The operating cost of capital (capital charge and depreciation) after major builds is a challenge for DHBs. With a greenfield development in Dunedin, the scale of the challenge is not manageable under current settings.

Response: The approach to affordability of both capital and resulting operating costs needs a fundamental re-think.