

The Treasury

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- [34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions
- [35] 9(2)(g)(ii) - to maintain the effective conduct of public affairs through protecting ministers, members of government organisations, officers and employees from improper pressure or harassment;
- [37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice
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Treasury Report: Capital Panel Advice Budget 2020

Date:	13 February 2020	Report No:	T2020/263
		File Number:	ST-4-8-4-4

Action sought

	Action sought	Deadline
Hon Grant Robertson Minister of Finance	<p>Note the output of the Capital Panel in this report to support you in determining Budget 20 investment decisions</p> <p>Note that the Treasury will work with system leaders on addressing the investment system issues raised in this report.</p> <p>Refer to the Associate Ministers of Finance and other Ministers as required for their information.</p>	None

Contact for telephone discussion (if required)

Name	Position		Telephone	1st Contact
Liz Innes	Principal Advisor, Investment Management and Asset Performance (IMAP)	[39]	N/A (mob)	
Rima Khorshid	Analyst, Investment Management and Asset Performance (IMAP)		N/A (mob)	✓
Craig Murphy	Manager, Investment Management and Asset Performance (IMAP)		[23]	

Minister's Office actions (if required)

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: Yes

Treasury Report: Capital Panel Advice Budget 2020

Executive Summary

You directed us to make improvements to the way we support capital investment decision-making through Budget 2020 [T2019/2686 refers]. We designed a process that considers attractiveness and achievability ahead of affordability, and sought advice from system leaders by convening a Capital Panel (the Panel). We have now completed this, and this report provides you with an overview of the initiative assessment process, the commentary from the panel on each initiative, and a summary of insights we gained from this work.

This report is intended to complement your consideration of the Budget 2020 Emerging Package Advice [T2020/157 refers] and provide additional information that incorporates system-wide perspective on significant investments proposed through Budget 2020. This report is *not* intended to recommend a specific package of investments; but rather to assess the relative achievability and attractiveness of significant investment proposals across all Budget 2020 cost pressure, priority and other packages.

The Panel reviewed the top 17 initiatives by value [33] out of the [33] (together seeking investment of [33] Where the Treasury Vote Team, or the Priority Minister, did not support an Initiative a Panel assessment has not been provided (this impacted 7 Initiatives). 10 Initiatives have been assessed in detail by the Panel ([33] of capital bids by value).

The Panel has provided a traffic light assessment of attractiveness (where green is most attractive and red is least attractive) and grouped initiatives by the level of concern about achievability from “no concerns” to “uncertain”. Generally the Panel noted a low level of planning [33] and where planning existed the Panel considered that it frequently showed optimism bias.

The Panel recommends that you make greater use of tagged contingencies to impose conditions and ensure investments are ready before funding is provided. More detailed initiative assessment information is provided in the Appendices for your information.

In running this process we, along with the system experts who contributed, identified three themes that – while not new – continue to require our attention:

- Even near-term investment information from agencies is unreliable.
- Business cases are not typically available to support investment decision-making.
- Agencies do not deliver investments as and when they expect to.

We recommend you direct the Treasury to work with officials across the system to consider these issues and what could be done to improve investment performance, and report back for an initial discussion in June.

Recommended Action

We recommend that you:

- a **note** the output of the Capital Panel in this report to support you in determining Budget 2020 investment decisions; particularly that there is significant optimism bias in agency investment plans and conditions should be used to ensure investment readiness before any funding is released; and
- b **note** that the Capital Panel has identified themes arising across investments that could negatively impact investment performance, particularly poor visibility of and planning for investments.
- c **note** that the Treasury will work with system leaders on addressing the investment system issues raised in this report.
- d **refer** to the Associate Ministers of Finance and other Ministers as required for their information.

Refer/not referred.

Craig Murphy

Manager, Investment Management and Asset Performance (IMAP)

Hon Grant Robertson

Minister of Finance

Treasury Report: Capital Panel Advice Budget 2020

Purpose of Report

1. This report provides you with the Capital Panel's (the Panel) advice based on its assessment of Budget 2020 (B20) Capital Initiatives (Initiatives).
2. This report responds to a request from your office for detailed system-level advice on the B20 Initiatives, which incorporates advice from the Treasury's Vote Team and Priority Groups where relevant [T2020/157 refers].
3. This report is set out in 3 sections:
 - a. Capital Initiative Assessment overview: Provides an overview of the panel process and assessment framework.
 - b. Capital Panel Initiative Assessment results: Provides a summary of the initiative assessments. Additional details are available in appendices A, B, C and D.
 - c. Capital Panel: Investment Insights. Provides the main themes noted by the Panel about government investment and the implications of these.

Capital Initiative Assessment Overview

Background

4. In October 2019 you directed us to change to the Capital process for B20 to improve the advice and information available to Ministers, including on the relative attractiveness and achievability of initiatives, as well as advice on affordability and managing within constraints [T2019/2686 refers].
5. In designing a process for large capital Initiatives in B20, you agreed that:
 - The process should include system level advice and analysis, particularly regarding overall achievability, prioritisation, and sequencing of investments.
 - Large capital investments will be considered alongside their operating costs.
 - Capital Initiatives will be considered within priority packages first so operating implications are factored in.
 - A centralised process for capital Initiatives should only consider significant Initiatives (85% by value).
 - Capital Initiatives are to be considered according to the attractiveness, achievability, and affordability from a central perspective.

Context

6. The purpose of the Capital Panel is to bring together important system-level perspectives to enrich initiative assessments, analysis and advice to support budget decision-making.
7. The Panel was led by the Treasury's Investment Management and Asset Performance (IMAP) team and included representatives from system roles critical to government investment including: the Government Chief Digital Officer (GCDO), Government Chief Data Steward (GCDS), New Zealand Infrastructure Commission (NZIC) and New Zealand Government Procurement and Property (NZGPP).
8. The Panel's advice provides system level insights to support Ministerial decision-making. That advice supplements the detailed Initiative level advice that is provided by the Treasury's Vote Team, or Priority Groups where relevant. The Panel is not preparing a capital package.

Panel's assessment framework and approach

9. The Panel reviewed the top 17 initiatives by value (together seeking investment of [33]) out of the total [33] Initiatives received (together seeking investment of [33]). These initiatives were distributed across the following sectors:

	<i>Initiatives Panel Reviewed Capital</i>
[33]	

10. The Panel's assessment framework includes three aspects: attractiveness, achievability and affordability – with a focus on attractiveness and achievability as Ministers are expected to apply the affordability constraint through the Budget process:
 - **Attractiveness** was considered with reference to Government commitments, Government priorities, deferred maintenance or critical renewal, correlation to the eradication of child poverty, and the targeted wellbeing impacts of the Initiative.
 - **Achievability** was considered using indicators such as the Investor Confidence Rating of the agency, the inherent risk of the Initiative, and the maturity of thinking about the investment (i.e. current state of business case development). There was also discussion about panel members' insights into agency capability and capacity, as well as the solution / approach and the market's capability and capacity to deliver the Initiative.
11. The Panel provides advice to the Treasury, and to the Minister of Finance via this report, to support discussions and decision-making on Capital investment as part of B20.

Government capital expenditure outside the budget process

12. The Government has announced that it is investing \$12 billion in additional infrastructure spend including:
 - [33]

and

 - \$8 billion for specific projects, including roading (\$5.3 billion), rail (\$1.1 billion), health facilities (\$300 million), Schools (\$400 million), decarbonising heating at hospitals and schools (\$200 million) and Skypath / Seapath across Auckland's Waitemata Harbour (\$400 million).
13. The impact and potential crossover of these investments has not been considered as part of the Panel's B20 advice.
14. A number of the announcements were made during the Panel's process and no information was available to the Panel on the "investment ready" status of these investments; however we expect that they will demand both agency and market capability, limiting the number of investments that can be progressed in parallel.

Capital Panel Initiative Assessment results

15. This section provides a brief overview of the Initiatives assessed by the Panel.
16. Where the Treasury Vote Team, or the Priority Minister, did not support an Initiative a Panel assessment has not been provided (this impacted 7 Initiatives). Ahead of the decision not to provide a formal assessment of those Initiatives, the Panel undertook a preliminary assessment to confirm that a System Leader's view was not in conflict with a Treasury Vote Team or the Priority Minister assessment. A list of the Initiatives not assessed is attached at appendix A.
17. In total, 10 Initiatives have been assessed in detail by the Panel ([33] by value). Those Initiatives are set out in the table below.

[33]
18. The key consideration for Ministers in a funding decision is the attractiveness of each Initiative, which is displayed within a Green (most attractive) to Red (least attractive) rating.

19. The Panel observed that, in general, agencies' capability and capacity is *the primary constraint* in the delivery of an Initiative. On that basis the Panel has constructed its advice around its level of achievability concern.
20. The three achievability groupings are:
 - a. **No achievability concerns.** These Initiatives are considered achievable. However, the attractiveness of the Initiative should be a key consideration in the funding decision
 - b. **Some achievability concerns.** These Initiatives are considered achievable - subject to additional work by the agency or the support of a System Leader. The level of achievability support should be considered in addition to the attractiveness when considering funding and
 - c. **Achievability uncertain.** The Panel has material achievability concerns with these Initiatives. The level of support needed is likely to be significant to realise the benefits of these Initiatives.
21. A summary of the grouping of Initiatives is set out in the table below. A more detailed summary of each Initiative is included as **Appendix B**.

[33]

22. In addition, to support you in your discussions with Budget Ministers you can find:
- a sector overview from each of the System Leaders at **Appendix C**;
 - an agency overview from each of the System Leaders (where relevant) at **Appendix D**; and
 - questions prepared by the Panel, to support a discussion between you and Responsible Ministers on the relative merits of initiatives at **Appendix E**.

Capital Panel: Investment Insights

23. The Panel observed three main themes which are explored in this section: the data supplied by agencies is incomplete, what data there is tends to be subject to optimism bias, and investment performance is relatively unknown – but seldom goes to plan.

Even near-term investment information from agencies is unreliable.

24. Agencies investment intentions provided in February 2019 were not a good indicator of the Initiatives agencies sought funding for in B20 - while [26,33] was received as part of the Budget process.
25. The table below shows expected and actual investment intentions for B20 by agency:
[26,33]

26. Agencies investment planning requires improvement to obtain an accurate investment pipeline. An accurate investment pipeline is essential for understanding the investment required to maintain the Government's current service-levels or pursue new opportunities.
27. An accurate forward view of investments is also important so we can present a well-coordinated government capital pipeline externally to attract engagement in local and international markets. We would expect increasing engagement to help drive better outcomes - particularly for large-scale infrastructure construction in New Zealand.
28. The quality of the investment pipeline reflects a need for agencies to improve their strategic planning, specifically their strategic asset management, and increase their focus on supporting investors – particularly Ministers – with accurate information and useful choices.

Business cases are not typically available to support investment decision-making.

29. Of 17 Initiatives assessed by the Panel, only ^[33] had a completed business case and were considered investment ready by the Panel. Agencies were generally seeking capital ahead of full information being available for Ministers to make an investment decision. A business case is important to identify the options for delivery at the outset - prior to committing any spend - and to create strategies for managing risk.
30. In the absence of a business case, costs and risks are baked in, rather than managed out - decreasing the benefit to cost ratio of even a highly viable project.
31. The lack of a business case also makes assessing Initiatives difficult as the information provided by agencies is insufficient and thinking is incomplete. A well-considered business case is also essential to help avoid common reasons for failure (for example lack of strategic fit, lack of senior management engagement, lack of stakeholder engagement).
32. The Panel considers that the lack of a business cases reflects capacity and capability issues in areas like collaboration, strategic planning and business casing within these agencies. Improved consultation with system leaders and the Treasury in the preparation of business cases can assist agencies to better understand the process and support them to deliver business cases.

Agencies do not deliver investments as and when they expect to.

33. ^[34]

34. The spend issues illustrated in 2019 may signal delivery capacity and capability of agencies – a theme noted by the Panel at a Vote level for a number of agencies. This probably reflects a lack of planning (indicated by the absence of a business case) or a lack of attention to detail in the phasing of appropriations.
35. There is a requirement for agencies to report back to Cabinet following the completion of significant investments which is not well complied with, and there is little else in place to manage investment performance. This makes accurate assessments of past investment performance complex.
36. The Panel noted that key metrics provided to an investment's governance group would be useful at a system level to identify issues more easily and early on to provide more targeted intervention to support the delivery of investments.

Treasury Analysis: It is timely to consider investment interventions

37. The Panel discussed capacity and capability at length. While they noted that market capability and capacity is tight in particular segments (including the agile ICT market in Wellington and in construction), the Panel considered that agency (or public sector) capability and capacity was the more important factor in achievability.

[33]

38. The Treasury considers that while market capacity constraints will continue to limit short-term growth in spending – particularly in construction – limits will be less meaningful over the longer term. Well-signalled investment could meet planned growth (subject to improving our investment forecasting), but public sector capability constraints remain a major challenge.
39. The 3 issues raised by the panel are not new but they are critical to a well-performing investment system. The strategic planning pilot you are leading with the Minister of State Services provides one way in to these issues; by supporting improvements to the authorising environment (focusing on Ministers and agency leaders); lifting strategic capability; and changing requirements for agencies to produce strategic plans [TR2019/3461 refers].
40. The Treasury considers that more work will be required to make a material improvement to investment management practices. We are working together with system leaders to improve investment performance and address the 3 issues raised by the panel.

Appendix A: Initiatives not considered by the Capital Panel in detail

[33]

Appendix B: System Leaders' Initiative summary

Group 1: No Achievability Concerns

[33,26]

Group 2: Some Achievability Concerns
[33,26]

Group 3: Achievability Uncertain

[33,26]

Appendix C: System Leaders' System Insights

GCDO

There is limited digital/ICT capability in the market, particularly the Wellington market, in agile delivery and shifting to modern platforms. Some agencies do not have the right capability in-house and the ability to supplement in the market is low. We encourage agencies to build capability in-house. However, in the short-term external contractors may be needed to upskill staff.

Some agencies are bidding for a significant number of digital/ICT Initiatives in B20. This raises concerns around the agencies capability and capacity to deliver if all the digital/ICT B20 Initiatives were funded. If a significant number of overlapping digital/ICT Initiatives are funded in the same year, there is a risk of government driving up demand, in a market that already suffers from a skills shortage. This may drive costs up if government agencies compete with each other and the private sector for external resources.

The Investments assessed by the Panel illustrate the potential for system and sector gains in the form of customer focused service design, better data sharing, reducing system risks and increased overall productivity. However, the implementation of these Initiatives is not without risk.

Risks and issues around privacy, security, assurance, governance, delivery, and fit-for-purpose technology solutions need to be considered when making investment decisions. The GCDO would like to see increased agency consultation with the Digital Public Service Branch on these risks early when designing and delivering Initiatives.

During the assessment of the Investments the GCDO have recommended that a number of agencies revise their delivery approaches or clarify costing models to better align with the Strategy. The Strategy will help agencies plan and develop future digital and ICT Initiatives to align with an all-of-government system direction. The GCDO has encouraged agencies to consider the Strategy in their development and implementation of digital/ICT Initiatives.

GCDS

Of the 17 Initiatives reviewed, 3 had a data focus. Those Initiatives were aligned to the Data Strategy and Roadmap and provided either an opportunity to improve wellbeing data, or, mitigate a risk to current data collection. However, none of the Initiatives fully demonstrated acknowledgement of these risks and opportunities. This highlights a need for greater engagement between the GCDS and agencies to improve the understanding of the Data Strategy and Roadmap and the value of data for the system.

The small number of data related Initiatives was not seen as an issue as the GCDS would expect that as the Data Investment Plan is further developed a clearer future pipeline should emerge. In addition, data related Initiatives are often of a much smaller scale and therefore are unlikely to appear in larger Investments.

Trust and use of data is of heightened concern at the moment given recent breaches, the perceived risks need to be managed as much as the actual ones. Changes to systems can have a flow on effect to the systems that may receive the data (both in processing and in data format). Therefore, investments need to adequately consider the impacts to the data system.

NZIC

NZIC, as part of its legislative mandate, is required to deliver the New Zealand 30 Year Infrastructure Strategy (the Strategy) by October 2021 and is in the early stages of that work stream. Once developed, the Strategy will provide Ministers and the wider infrastructure sector with a greater understanding of the current state of key infrastructure sectors and their contribution to achieving the objectives sought by the Strategy. It will therefore be a useful framework to help inform the capital investment decision making process.

In general terms, the infrastructure sector can respond to the Government's infrastructure intentions and pipeline provided that they are given sufficient lead times to plan and coordinate. However, that requires that agencies are also sufficiently resourced and experienced to manage the planned portfolio of projects. A well-presented and coordinated capital pipeline from agencies is significantly attractive to both the local and international markets and will enable better outcomes to be delivered for large-scale infrastructure construction in New Zealand.

NZGPP

There is an opportunity to significantly impact all 4 outcome areas prioritised by Cabinet (increasing access for New Zealand businesses, construction skills and training, improving conditions for New Zealand workers, and reducing emissions and waste) through the Government's capital programme. This will be dependent on agency leadership and procurement teams, with the support of NZGPP, embracing these opportunities.

It is encouraging that in several cases, agencies are using procurement methods that allow multiple vendors to contribute to service delivery, avoiding the concentration of spend and risk.

Many of the markets that government agencies rely on to deliver key programmes are currently operating under constrained capacity, and an increase in government spending may further constrain their ability to deliver. There are steps that government can take to mitigate these risks, such as through early engagement and communication with key markets, a clear pipeline of work (by sector and region), and investment in capacity and capability building. This is particularly important for sectors on which government will rely heavily in the coming decade.

Much work has been done with the construction sector to develop the Construction Sector Accord Transformation Plan. When agencies are procuring for construction projects, they should ensure their process and practice aligns with the outcomes and principles of the Construction Sector Accord. They should also ensure they are aware of good practice and lessons learned demonstrated in the Accord beacon projects, and stay up to date with improvements the Accord delivers in areas such as contracting methods, health and safety, and people development. It is expected that agencies show evidence of this in tender documents and business cases.

Where procurement of specialist goods and services requires agencies to source them from overseas, NZGPP, within the constraints that exist, to investigate the opportunities for agencies to give opportunities for New Zealand businesses to deliver components or ongoing maintenance services.

Annex D: System Leaders' Agency Insights

[26,34]

Annex E: System Leaders' Initiative Questions

[33]

