The Treasury

Budget 2022 Information Release

August 2022

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Key to sections of the Act under which information has been withheld:

[1] 6(a) - to avoid prejudice to the security or defence of New Zealand or the international relations of the government

[23] 9(2)(a) - to protect the privacy of natural persons, including deceased people

[25] 9(2)(b)(ii) - to protect the commercial position of the person who supplied the information or who is the subject of the information

[27] 9(2)(ba)(ii) - to protect information which is subject to an obligation of confidence or which any person has been or could be compelled to provide under the authority of any enactment, where the making available of the information would be likely otherwise to damage the public interest

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[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;

[36] 9(2)(h) - to maintain legal professional privilege

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

[40] Out of Scope

[41] 18(c)(i) - that the making available of the information requested would be contrary to the provisions of a specified enactment

[42] 18(d) - information is already publicly available or will be publicly available soon

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [1] appearing where information has been withheld in a release document refers to section 6(a).

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NEW ZEALAND INFRASTRUCTURE COMMISSION
Te Waihanga

TE TAI ŌHANGA
THE TREASURY

Reference: T2021/2883 (Treasury)
TW/2021/103 (Te Waihanga)

Date: 16 November 2021

To: Minister of Finance and for Infrastructure (Hon Grant Robertson)

Deadline: None

Aide Memoire: Impact of cost escalation on government projects

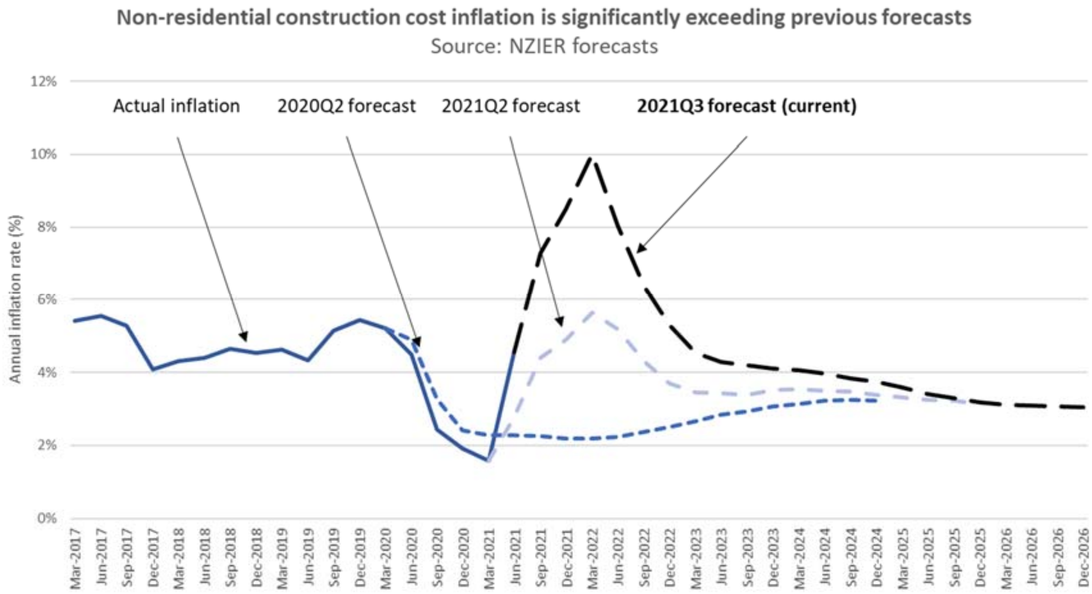
This aide memoire responds to your request for information about the potential impact of cost escalations on government infrastructure projects. As Te Waihanga foreshadowed in September 2021, a range of COVID-19 related matters continue to drive costs through the construction supply chain [TW/2021/88 Refers].

Since September, construction prices have risen again, and there are more risks ahead

Construction price inflation has surged over the last quarter, and NZIER forecasts now indicate annual non-residential construction cost inflation will increase to 10 percent in March 2022, which is consistent with reports from across government.

Construction price inflation forecasts have been revised upwards several times over the last year, and so officials consider it reasonable to expect ongoing volatility and future risk. Labour is likely to be tight over the medium term, reflecting high demand for construction and lags in training and international recruitment. Material supply chain issues are likely to be transitory but may persist if the COVID-19 pandemic continues to affect manufacturing and port operations in Asia.

Although unknown, the fiscal impact of near-term inflationary pressures is likely to be significant. By way of example, Te Waihanga's Infrastructure Pipeline currently tracks $64 billion in spending intentions across government, local government and the private sector. Relative to previous construction price inflation assumptions, a one-off inflationary surge of 10 percent (as indicated by NZIER – see graph overleaf) will require additional funding of around $4.5 billion to complete the intended projects. This helps indicate the scale of potential cost pressures (it is not a forecast of the additional investment requirements).



Generally, construction price inflation can be attributed to four major cost drivers:

1. **Unavoidable / input cost increases** – This largely relates to rising costs in commodities and materials like iron, copper and services like international freight.

2. **Domestic capacity challenges** – Materials shortages include structural and non-structural wood, electrical equipment and plumbing materials and fittings, and most significantly, domestic competition for labour.

3. **Problems with time and scheduling** – even where materials and labour are available, there are bottlenecks causing issues in supply-chains and delivery, which can have cumulative effects.

4. **Management and practice problems** – other issues can be exacerbated by poor practice (like scope creep) or failure to anticipate or manage risks.

This will drive costs (and delays) on projects that are underway, and those to come

While we don't have the quality or depth of information to quantify this well now, officials have provided indications about the cost escalation arising on some government infrastructure projects (those that are expected to experience financial pressure in the short term – through Budget 22 or in the next year). A list is attached at Annex One.

Mitigating the impact of these cost escalations (and delays)

Some of these cost escalations can, and should, be managed at the project level. Other risks, like domestic competition for products or labour, cannot reasonably be mitigated by contingencies that were established under a different environment.

More work is required to understand which costs can reasonably be met by project contingency, what other cost management options may be available (for example by revising scope of individual projects or introducing sequencing across the portfolio), which projects may require additional funding and how much funding is required (if any), and what impact this may have on Budget 22 and the capital allowance.

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Liz Innes, Principal Advisor, Te Waihanga, [23]
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Annex 1 – indicative cost pressures arising on projects in the near-term

Delivery Agency/Entity	Project/Programme Name	Current Estimate	Project Stage	Indicative Size of Cost Pressure	Project/Cost Pressure Notes
Ministry of Health	New Dunedin Hospital	[38]	Implementation Business Case	[38]	
NZ Upgrade Programme (NZUP) (Transport Projects)	Multiple projects		Various Stages		

Delivery Agency/Entity	Project/Programme Name	Current Estimate	Project Stage	Indicative Size of Cost Pressure	Project/Cost Pressure Notes
Kāinga Ora - Homes and Communities	Auckland LSPs	[38]	Various Stages	[38]	

Delivery Agency/Entity	Project/Programme Name	Current Estimate	Project Stage	Indicative Size of Cost Pressure	Project/Cost Pressure Notes
Waka Kotahi	Transmission Gully PPP	[38]	In Construction	[38]	
	Puhoi to Warkworth PPP		In Construction		

Delivery Agency/Entity	Project/Programme Name	Current Estimate	Project Stage	Indicative Size of Cost Pressure	Project/Cost Pressure Notes
City Rail Link	City Rail Link	[38]	In Construction	[38]	
New Zealand Defence Force	Construction Inflation (invited for B22)		NA		