Crombie Lockwood Tower
Level 16, 191 Queen Street
PO Box 7244
Wellesley Street
Auckland 1141
New Zealand

Phone: +64 9 377 5570
Email: info@infrastructure.org.nz

25 February 2020

Hon Grant Robertson
Minister of Finance
Parliament Buildings
Private Bag 18041
Wellington 6160

Recommendation for Accelerated Urban Growth Partnerships in May Budget

Dear Minister,

Infrastructure New Zealand commends the Government on its commitment to the most ambitious investment programme in many decades.

This letter sets out how the Government can use a long-term Urban Growth Partnership Fund (the 'Fund') to leverage the $4 billion unallocated capital allowance and generate billions of dollars of new third-party infrastructure investment. With a new partnership delivery approach, the Fund could catalyse local government, iwi and private sector investment to create transformational outcomes in line with Government objectives.

The Fund would create a multi-year grant funding framework for regional spatial partnerships as per your Urban Growth Agenda. The purpose of this Fund is to:

- partner with and crowd in local government, iwi and communities;
- to use global best practise in infrastructure governance, planning, funding and delivery; and
- to use this regional all-of-government approach to maximise outcomes, create transformational change and mitigate risks.

This letter incorporates and updates the proposal contained in Infrastructure New Zealand's 2019 Building Regions report[i].

What's the Problem?

Nearly nine out of ten New Zealanders live in urban areas[ii] where the housing crisis, looming urban water crisis, transport congestion, climate and environmental impacts have the largest national impacts on wellbeing.

Infrastructure New Zealand's desktop analysis shows that there is an urgent need for an at least an additional $100 billion of infrastructure investment.[iii] The $12 billion New Zealand Upgrade Programme announcement represents around a 10 per cent increase in planned investment over the next decade, however it is less than a 4 per cent increase in the current $304 billion stock of New Zealand's infrastructure assets[iv].

The core problem statement for why accelerated Urban Growth Partnership funding is required is:

- Local authority funding arrangements do not incentivise growth, and cap investment due to rating agency borrowing limits;
- Central agencies have limited capabilities in the practicalities of delivering urban growth, especially in land use planning, RMA approvals and local community consultation; and
- Central agencies and local government are poorly aligned and coordinated.

The problems in our urban water, transport and housing space are complex, interdependent and massively costly. Our research shows that central government has 90 per cent of total government revenue in New Zealand and central and local government have 82 per cent of total infrastructure assets in New Zealand. Given central government sets the legislative system and conditions for local government and it is the ultimate guarantor/backstop for local government, it is very clear to us that central government is the dominant actor in all positive and negative outcomes from New Zealand's infrastructure system.

Infrastructure NZ does not believe it is sustainable for the Crown to fund the required amounts on its own. The Crown's 2018 Investment Statement – Investing for Wellbeing showed budget capex bids exceeding availability by 448 per cent[v], with the demand trend continuing to increase.

Collaborative spatial planning and investment can unlock growth opportunities, but it requires programme or framework level funding rather than a conventional project by project approach. If, instead of direct Crown capital contributions, the funding mechanism for much-needed infrastructure investment became an objective formula, linked to regional GDP and other qualitative outcomes, and paid to the Growth Partnership, the Crown could leverage local government and private sector investment and ensure that investment was channelled in a way which supported national outcomes.

What's the Benefit for Government?

Despite your Government's significant and positive reform agenda in this urban growth space, the scale of the task ahead is too large for the Crown to address on its own. The three key benefits for Government are:

1. enrolling new partners to help with the urban development task;
2. delivering optimal value for money; and
3. in achieving an all-of-government approach which recognizes the synergies and interdependencies of infrastructure.

Co-investment at the regional level could generate significant new Crown revenues and generate much larger outcomes. Our key point is that **a $100 million grant from the Fund could generate almost $2,500 million worth of housing related investment[vi]**, stimulated by new housing, water and transport infrastructure. We estimate that $367 million of GST would be generated for the $100 million investment (cost/benefit ratio of 3.67x), before any personal / corporate taxes or productivity multipliers are considered. We acknowledge that the Crown would face further costs for national roads, hospitals and schools, however this example has deliberately been left high level to highlight the substantial opportunity, provided the Crown can remove its traditional barriers to direct grant funding alongside councils.

We understand that the Crown has been briefed on a looming funding issue for Tauranga City Council ('TCC') which could see circa $300m of housing related infrastructure investment be stopped. The reason TCC can't fund its long-term plan capex is that cost increases, population growth and leaky building claims mean it will breach its LGFA debt cap, without politically unachievable rates increases in the order of 30-40% per annum. NZIER have prepared a report which shows that the 10-year impact of this failure to invest in local pipes and roads of:

- a housing shortfall of 8,436 units by Year 10;
- cumulative GDP foregone of $2,547 million by Year 10;
- 1,580 - 2,320 construction jobs lost, worth an additional $118-$174 million of GDP foregone; and
- house price rises of $702,082 over 10 years.

The TCC case study above would see significant lost opportunity for Crown revenues, impose further costs on the Crown (assuming accommodation supplement and other housing related costs rise) and would lead to spiralling wellbeing losses. The counterfactual is that if Crown granted $100m to TCC, it could borrow an additional $250m, creating enough headroom for the capex to continue. The cumulative GST on $2,547 million of GDP is $382 million, significantly exceeding the Crown's initial $100 million investment.

Incentivizing local authorities and the regional arms of Crown delivery agencies to work together on spatial partnerships will generate substantial procurement savings and productivity gains. A recent estimate of annual infrastructure spending was $4 billion from local government and $8 billion from central government. If this $12 billion was supported by multi-year funding, allowing for multi-year procurement deals to be executed, at least $1.2 billion per annum of cost savings[vii] could be delivered. For reference purposes, $1.2 billion of savings per annum would come close to funding the equivalent of a new Dunedin Hospital every year. If 20% could be achieved, savings would be $2.4 billion.

To get good wellbeing outcomes, infrastructure interdependencies need to be recognized, planned, funded and delivered as part of a system at the regional level. Central government agencies such as NZTA, the DHBs, schools and Kāinga Ora have traditionally delivered their services in silos, focusing heavily on quality of spending within these silos, but ignoring the key interdependencies. Executing infrastructure investment in a coordinated, spatially planned way is possible at the regional level, while it has not been successful at the national level.

Infrastructure New Zealand

Infrastructure New Zealand recently took its board to Whangarei to understand regional infrastructure opportunities and challenges. It was striking to us that the Northland DHB has extremely poor hospital infrastructure and health outcomes, but there is no regional spatial plan to address the root causes of these through coordinated investments in road safety, healthy homes, education and other interventions. Failure to plan, fund and deliver these investments in a coordinated way wastes millions of taxpayers' dollars and more importantly it exacerbates the poor outcomes. Local authorities have very important complementary roles in delivering health outcomes through clean water, local transport, high-quality housing and in bringing the community along to the resource management decisions to execute these plans, yet councils are excluded from national investment decision making that affects their region.

Management of Risk

A critical barrier to the Crown providing funding to local authorities has been a perceived lack of capacity and capability to spend money well. We suggest that this issue be addressed by:

1. Using regional scale governance and delivery frameworks, in partnership with iwi and the regional representatives of Crown agencies such as Kāinga Ora, Ministry of Education, NZTA, MBIE and others. Crown could have a majority voting position in these governance entities, provided it maintained a partnership approach; and
2. Requiring the use of performance rating tools which align the parties – we suggest that Treasury's Investor Confidence Rating would provide transparent oversight of how well the regional partnership executes on its plan.

Local government will undertake its Long-Term Plan consultations between April and October 2020. We recommend that the Crown uses this period of ratepayer consultation to offer new, long term commitments from the Fund in return for significant changes to key areas of local government operations which present barriers to national progress.

Examples of local government concessions which could be sought include:

- co-governance and/or co-ownership models in urban water & transport;
- alignment of local and regional plans to national priorities;
- asset sales and/or deconsolidation of some council assets;

- support for economic regulation / pricing of urban water or transport;
- support for national strategies or coordination in airports and marine ports;
- requirement for local government to enter into multi-year procurement arrangements which could generate significant cost/value savings;
- requirements for local government to adopt models such as Treasury's Investor Confidence Rating to demonstrate capacity and competency in deploying funds well;

Transformational outcomes could be delivered if councils can be encouraged to significantly change their current mode of operation in return for this new revenue source. Potential benefits could also include:

1. Deconsolidation of water utilities such as Watercare. Deconsolidation[viii], supported by a pricing regime for urban water, could allow the new independent entity to be treated as a standalone utility and raise its borrowing threshold. Watercare currently has debt of $1,612m and EBITDA of $1,027m, creating a gearing ratio of 1.57x. For comparison, Transpower has gearing of 4.4x and the UK water companies average 6.0x gearing. If Watercare were able to leverage at the same rate as Transpower an extra $2.9 billion could be borrowed.
2. Support for economic regulation of urban water and/or transport – if ratepayers, through the Long-Term Plan consultation, are provided credible choices to accept pricing of water and transport in return for significant Crown co-investment in these assets, this Government could create momentum for positive change.

Conclusion

This proposal would give effect to the Government's Urban Growth Agenda by substantially removing two key barriers – insufficient funding for local and regional government and institutional misalignment between local, regional and central government.

It is counterintuitive for central government to give up a measure of control, however Infrastructure New Zealand urges you to use this global best practice approach to optimize wellbeing outcomes, to crowd in partners, create transformational change and mitigate risks.

I acknowledge there is risk for the Crown in changing its approach to funding, governance and delivery in this manner, however if you take a leadership position on this, transformational outcomes are possible. I would love to meet you to discuss as soon as possible.

Yours sincerely

Paul Blair

CEO, Infrastructure New Zealand

Copy to:

Hon Shane Jones, Minister for Infrastructure, Regional Economic Development and Forestry;

Hon Nanaia Mahuta, Minister for Local Government and Māori Development;

Hon James Shaw, Minister for Climate Change

Hon David Parker, Minister for the Environment;

Hon Phil Twyford, Minister for Urban Development, Transport & Economic Development; and

Hon Dr Megan Woods, Minister for Housing, Greater Christchurch Regeneration, Energy & Resources

[ix]Appendix 1

Building Regions: A Waikato Example

1. The Waikato Regional Partnership established to deliver *Waikato 2050* vision. Regional heads of key Crown agencies, Tainui, and representatives of 11 Mayors govern and appoint WRP SPV as delivery agent
2. Waikato Spatial Plan translates the vision into joined-up 30-year investment plan
3. Crown borrows $100m at 1.3%, provides 10-year grant funding to WRP. Waikato councils borrow $250m against grant income. WRP funds 7,000 new home lots ($50k infrastructure per home)
4. IFF and Kāinga Ora powers further assist delivery. 'Mum and Dad' buyers put up 150 sqm home at $2,000/sqm ($2.1b investment on $350m infrastructure). Crown receives $367m GST (ignoring personal & corporate taxes) on $100m investment.
5. WRP obtains 'C' Investor Confidence Rating (same as NZTA). WRP can obtain 10% cost savings ($35m) through 10-year procurement deal that also specifies local employment, purchasing, and apprenticeship content.

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[i] Building Regions

[ii] Department of Statistics definition of 'urban' is populations greater than 1,000 residents

[iii] Infrastructure New Zealand estimates

[iv] $304 billion of national infrastructure assets have been categorised by Infrastructure New Zealand's desktop research (100 Day Report).

[v] https://treasury.govt.nz/sites/default/files/2018-03/is18-hphp-wellbeing.pdf

[vi] See example in Appendix 1 above

[vii] Uses midpoint of 5-15% estimate of cost savings from world class procurement in our Entwine report. Watercare entered into a 10-year procurement transaction recently, saving 20% of procurement cost.

[viii] Deconsolidation could occur where multiple councils own a minority stake in a larger water body, where Crown entities including ACC or NZ Super were to co-invest or where rating agencies could be persuaded to take a different approach to water company deconsolidation.