Office of the Minister for Building and Housing

The Chair
Cabinet Economic Growth and Infrastructure Committee

Housing Infrastructure Fund: implementation and structure

Proposals

1 This paper advises Cabinet of progress in establishing and implementing the Housing Infrastructure Fund (HIF). In particular, it seeks agreement to a funding mechanism for the provision of water infrastructure, a HIF governance model; confirmation of the decision-making process for proposals; and the addition of a lower-cost housing assessment criterion.

2 The paper also recommends that the authority to refine the transport and water infrastructure funding mechanisms, and the Call for Final Proposals process; and to establish appropriations; be delegated to Ministerial sub-groups.[1]

Executive summary

3 On 27 June 2016, Cabinet agreed to the establishment of the HIF to assist high-growth councils facing financial constraints to finance infrastructure needed to unlock residential development [CAB-16-MIN-0303 refers].

4 On 7 September 2016, the Economic Growth and Infrastructure Committee (EGI), with the Power to Act for Cabinet, agreed to overall governance arrangements and assessment criteria for the operation of the HIF. EGI also agreed that there be an expectation of repayment of HIF funding within ten years, rather than an obligation [EGI-16-MIN-0228 refers].

5 In this paper, I am recommending:

a. *A preferred funding mechanism for water infrastructure projects* – it will be difficult to provide reasonable assuredness of the Crown recouping its HIF water infrastructure investments, without placing a corresponding obligation on councils to repay funds. Mechanisms that involved the Crown creating a special purpose vehicle to own water assets were considered, but were found to be an unnecessary and costly complication that still resulted in additional council debt. The preferred funding mechanism – subordinated debt – therefore focuses on placing the burden of debt on councils but structuring repayments to ease councils' financial constraints, while ensuring recovery of Crown funds within a reasonable time period.

[1] Consisting of the Ministers of Finance, Transport, and Building and Housing, in combinations for decisions relating to their respective portfolios.

b. *A preferred governance model for the HIF* – the HIF Independent Assessment Panel (the Panel) – to provide an objective, 'arm's length' assessment of proposals, and to recommend preferred proposals to Ministers. The Panel could then provide further independent oversight of HIF performance. Administration, management, and monitoring of HIF investments would be the responsibility of a dedicated Ministry of Business, Innovation and Employment (MBIE) commercial unit.

c. *Confirmation of an amended decision-making process for the assessment and approval of proposals* – the process has been revised to:

  i take into account the Panel as the preferred body to assess proposals;

  ii accommodate the New Zealand Transport Agency's (NZTA's) obligations under the Land Transport Management Act 2003 (LTMA) to approve proposals that qualify for National Land Transport Fund (NLTF) funding; and

  iii provide an *in-principle* programme of proposals ahead of discussions with councils and deciding a finalised programme.

d. *The addition of a 'lower-cost housing' criterion for the assessment of funding proposals* – as indicated in the September 2016 Cabinet paper, the addition of this criterion will encourage more affordable houses to be prioritised through the HIF.

6 To facilitate the timely delivery of the HIF, particularly for steps over the next three months, I am seeking approval for the delegation of decisions to Ministerial sub-groups on:

a. Refinements to the transport and water infrastructure funding mechanisms – in regard to transport, to respond to a possible need to amend the proposed mechanism using Funding Assistance Rates (FAR); and for water, to provide agility in responding to councils' different financial situations, especially in relation to debt-to-revenue ratio limits.

b. The process for receiving and evaluating proposals, including use of an assessment framework – this process will be further developed following consideration of Indicative Proposals, which are to be lodged by 2 December 2016, ahead of a Call for Final Proposals in late January 2017.

c. Establishing appropriations for the drawdown of HIF funds and concessionary charge, as the total amount and expected split between transport and water infrastructure funding will not be known until a recommended package of projects has been determined.

Background/Context

Cabinet and EGI considerations

7 On 7 September 2016, EGI with Power to Act agreed to the overall governance arrangements, application process, conditions, and assessment criteria, for the establishment and operation of the HIF. EGI also agreed that there be a general expectation that HIF funds are recovered within ten years, rather than an obligation [EGI-16-MIN-0228 refers].

8 In addition, EGI gave *in principle* agreement to the decision-making process for final proposals, to allow time for the NZTA Board to consider the proposed arrangements.

9 EGI also directed officials to report back on funding and administrative arrangements for the establishment and operation of the HIF, and invited me to report back on results from work into how lower-cost housing can be prioritised through the HIF.

Initiation of HIF proposals process – Call for Indicative Proposals

10 On 22 September 2016, I announced the Call for Indicative Proposals to access HIF funds. These proposals, developed by council officials, were to be submitted to the Ministry of Business, Innovation and Employment (MBIE) by 2 December 2016. The Call for Final Proposals is planned to be announced in late January 2017. Final proposals, which will require the support of elected councillors, will be due for lodgement by the end of March 2017.

Consultation on funding mechanisms

11 MBIE and Treasury officials have consulted with eligible councils, the Local Government Funding Agency (LGFA), and accountancy and legal advisors, particularly on funding mechanisms for water infrastructure.

12 Consultations have identified a concern that for councils with current high levels of debt, the acceptance of interest-free debt would still push councils closer to, or over their debt limits, which could result in a credit rating downgrade and consequent higher overall interest payments. An overall increase in councils' borrowing costs as a result of HIF debt could suppress future investment in housing infrastructure, which could ultimately defeat the purpose of the HIF.

13 Several councils have stated this could be a deterrent to applying for HIF funds, and the LGFA also expressed concerns that the cost of borrowing for all councils could increase as a result. However, councils could not suggest a funding mechanism that would not impact on their accounts, and it is expected that most eligible councils will submit proposals, as it remains the cheapest available source of funding.

Funding split between transport and water infrastructure proposals

14 Feedback from councils indicates that transport infrastructure is expected to account for approximately 65-75 percent of funding proposals, and water infrastructure, 25-35 percent. A more accurate break-up will be known following consideration of indicative proposals.

Preferred funding mechanisms for the provision of HIF funding

Preferred funding mechanism for transport infrastructure

15 As previously agreed, the NZTA will administer funds for the transport infrastructure components of HIF projects, through the National Land Transport Fund (NLTF) and Funding Assistance Rate (FAR) arrangements. These processes are governed by the LTMA and arrangements are progressing.

FAR and the collection of development contributions for transport infrastructure

16 Under the FAR mechanism, the NZTA would borrow funds from the Crown to front-load their assistance to councils. It is envisaged that the NZTA would then repay their loan through a reduction in FAR assistance over a number of subsequent years. In these latter years, a council would have to make up the shortfall in their reduced FAR funding through increased revenue from other sources or reprioritisation of other programmes.

17 s 9(2)(ba)(i) [redacted] This issue arises from a provision in the Local Government Act 2002 that requires a council to only charge development contributions where the council (rather than the NZTA) has incurred capital expenditure.

18 Development contributions only represent one possible funding source through which councils can offset reduced FAR revenue (others include access charges, user charges, and targeted rates). As such, an inability to charge development contributions does not make the FAR approach invalid.

19 Officials are investigating council concerns to see whether they can be addressed through alternative FAR structural arrangements, such as spreading the application of FAR adjustments over a wider set of council projects / programmes (rather than being tied to a specific transport project as currently envisaged by councils).

20 In the event that an alternative approach to the FAR is required, I propose that the Ministers of Finance, Transport, and Building and Housing be authorised to make further decisions in relation to the transport funding mechanism. This will facilitate the timely release of the Call for Final Proposals in late January 2017.

Preferred funding mechanism for water infrastructure

21 The original goal of the HIF was to bring forward infrastructure investments for housing in high-growth, debt-constrained councils while having no impact on council balance sheets. Accountancy advice was obtained from PricewaterhouseCoopers (PwC) on possible funding mechanisms that could achieve the dual aims of ensuring the Crown recoups its expenditure on water infrastructure, and minimising the balance sheet impacts for councils facing financial constraints.

22 Advice from the Office of the Auditor-General, the Treasury, and the LGFA is that each of the identified mechanisms carry significant risks and challenges to both the Crown and to councils. Of particular note is advice that:

a. The objective of a council not having to show repayment obligations as debt (to remain within borrowing limits) appears to be incompatible with the Crown requiring certainty of recouping its investment capital, as any actual or perceived repayment obligation is likely to be recorded as a liability in council accounts, and the removal of any enforceable obligation creates a risk of non-repayment.

b. Financial reporting standards are based on accounting in accordance with the substance of transactions, rather than their legal form – this raises the prospect that, although repayment arrangements could be structured to avoid a legal definition of liability or debt, auditors and credit rating agencies may still treat such arrangements as a liability or debt.[2]

23 Following careful consideration by officials and further consultation with the LGFA and target councils, a preferred mechanism*, subordinated debt*, has been identified for water infrastructure. Other funding mechanisms were identified and subsequently eliminated from further consideration. A summary of these are at Appendix One.

24 *Subordinated debt* – council recognises a debt obligation, with this being subordinate to other debts. A repayment agreement would be developed for each successful proposal, with payments linked to the likely progress of development. Loan agreements could contain several provisions, including:

a. an initial repayment 'holiday' to allow for the expected time required for infrastructure to be expediently built;

b. penalty amounts or an alternative repayment structure to be applied in the event of missed repayments; and

c. any outstanding balance would require payment at the end of the loan term, and if unpaid, would accrue interest at standard commercial rates.

Forms of repayment

25 The repayment agreement could take one of several forms:

a. *Scheduled from drawdown* (preferred form) – repayments commence according to a pre-determined schedule. This may be more attractive for councils that have reasonable headroom in their debt-to-revenue ratio limits.

b. *Scheduled from a trigger point* – scheduled repayments commence once a particular trigger point is reached (such as a subdivision or building consent approval, or the initial receipt of development contributions).

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[2] The requirement for councils to repay the Crown was stated when the HIF was announced on 3 July 2016.

c. *Milestone* – repayments (with specified amounts) are only made as development milestones are reached, such as consent approvals, receipt of development contributions, and construction of infrastructure and housing.

d. *Contingent* – repayments are made when a council receives development contributions or targeted rates revenue from the development, with repayments equivalent to the revenue received.

26 Most councils may prefer to use milestone or contingent repayments, as these place less of a burden on councils' balance sheets by linking repayments to the inflow of development revenue. However, to encourage certainty of repayment in an earlier timeframe, I am proposing that subordinated debt with scheduled repayments be the preferred funding mechanism for water infrastructure.

27 Councils have an incentive to delay repayment, with a longer repayment timeframe on a zero-interest loan minimising the present value of payments over time. Councils would only be allowed to use a non-scheduled repayment form if they can provide details of their fiscal situation, particularly relating to debt-to-revenue ratios, that indicate an alternative repayment form is required for these councils to be able to benefit from the HIF.

28 I also propose that any further decisions on variations to this funding mechanism be delegated to the Ministers of Finance, and Building and Housing.

Timeframe for repayment of HIF funds

29 On 7 September 2016, EGI agreed to an expectation of council repayment of funds within ten years, rather than an obligation [EGI-16-MIN-0228].

30 During consultations on water infrastructure funding mechanisms, councils s 9(2)(ba)(i) [redacted] expressed concerns with their ability to repay HIF funds within ten years, with periods of 20-25 years regularly mentioned. Their comments focused on two aspects:

a. Debt-to-revenue ratio limits allow little headroom for many councils to commit to scheduled repayments, particularly in the short- to medium-term.

b. A contingent repayment approach could link repayments to development contributions and/or targeted rates. However, the revenue would likely be insufficient to fully repay HIF funding within ten years.

31 A relaxation of repayment provisions, via increased timeframes, would increase Crown risks, and the costs of lending. There is also a need to balance the competing interests of the Crown and councils, and to be consistent with determining the form of repayment.

32 It is also important to maintain pressure on councils to ensure that proposed developments are accelerated, to meet the HIF objective of providing accelerated availability of serviced land for housing development – more houses faster.

33 I therefore propose that an extension of the loan term beyond ten years only be considered where a council can provide details of their fiscal situation that indicates a longer repayment term is required to benefit from the HIF, and that any outstanding balances after ten years would ordinarily incur interest at standard commercial rates.

Exemption from interest for extended repayment timeframes

34 The provision of funding beyond ten years could be interest free (the Crown incurs these costs), or at standard interest rates (councils incur the costs).

35 The benefits of restricting the interest-free treatment of HIF funding to the initial ten years following drawdown include:

a. limiting the impact on Crown accounts due to concessionary charges;

b. incentivising councils to generate revenue from housing developments on the serviced land at the earliest possible time;

c. prioritising proposals that provide for faster recovery of HIF funds; and

d. providing greater certainty about the fiscal cost of the investments.

36 For transport infrastructure, the imposition of interest on loans to the NZTA would require the agreement of the NZTA Board. Initial indications are that NZTA would be supportive of loan terms beyond ten years, but not supportive of interest charges being applied, as interest costs could not be captured in FAR cash flow adjustments with councils.

37 I am recommending that, due to the potential impact on Crown accounts, any council request for an exemption from interest on loan balances after ten years, which may also apply, with the NZTA Board's approval, to the loan from the Crown to the NZTA, would require the approval of Cabinet.

Ownership of water infrastructure assets

38 Earlier advice to Cabinet suggested that a preferred funding mechanism would likely require Crown ownership of water infrastructure [CAB-16-MIN-0303]. This was based on a subsequently disproven assumption that Crown ownership could avoid impacts on council balance sheets.

39 After further anyalsis it is now known there would be few advantages, if any, for the Crown to own water assets. In particular:

a. There would be limited incentive for a council to purchase assets without a prior agreement to purchase. This would negate the purpose of assisting councils that have financial constraints, as it would confirm an obligation to pay, and could be treated as a form of debt by credit rating agencies.

b. Assets would be likely to have only one interested purchaser, being the relevant council, and therefore in such an uncompetitive market, it would be unlikely for the Crown to fully recover its investment, especially for a depreciated asset.

c. Lack of Crown capacity or expertise in owning and operating water assets.

d. Operational complexity in the Crown maintaining an asset that is integrated into a broader, separately-controlled water infrastructure system.

e. Significant ongoing administration and management costs for a special purpose vehicle to own the assets on behalf of the Crown.

40 s 9(2)(h) [redacted]

41 Therefore, to allow Crown ownership of water infrastructure, changes to existing legislation would be required. In addition, if the Crown were to have ownership of the water infrastructure, at the end of any joint arrangement it would be left with a devalued asset that would have only a single potential purchaser – the council.

42 I am therefore proposing that ownership of water infrastructure funded through the HIF be vested immediately with the relevant council/territorial authority. As detailed below, it is noted that this approach also removes the need (and expense) for a new Crown company to be established to own and operate water infrastructure.

HIF governance model

A preferred form of HIF governance is dependent on the water funding mechanism

43 Several governance models for the HIF have been considered by officials and PwC, including:

a. Within existing departmental structures;

b. Crown entity under Schedule 2 of the Crown Entities Act 2004; and

c. Crown company under Schedule 4A of the Public Finance Act 1989 (PFA).

44 The preferred governance model is dependent on the nature and characteristics of funding arrangements proposed for water infrastructure, with the Treasury suggesting that a decision on the governance model should follow agreement on a preferred water infrastructure funding mechanism.

45 I previously indicated that a Crown-owned company under Schedule 4A of the PFA would be the likely management form. However, this is no longer preferred, for several reasons:

a. The Schedule 4A model, which would also likely include joint venture companies, would be complicated, expensive and time-consuming for the Crown and councils to establish and operate;

b. As Crown ownership of water infrastructure is no longer considered feasible, there is no benefit or requirement for an ownership vehicle; and

c. The establishment of a Crown entity is unlikely to assist more favourable accounting treatment of councils' liabilities to repay HIF funding.

46 I therefore recommend that the governance model for the evaluation and selection of a recommended programme of works, and ongoing management of the HIF, be[3]:

a. *HIF Independent Assessment Panel (the Panel)* – to be appointed by Ministers through the Appointments and Honours Cabinet Committee process in early 2017. Expertise would cover governance, infrastructure development, and financing. The Panel, following NZTA Board approval of transport proposals that qualify for NLTF funding, would select proposals and recommend an *in-principle* programme of works to the Ministers of Finance, Transport, and Building and Housing. Following NZTA and Panel agreement with councils on funding terms, the Panel would recommend a final programme of proposals to Ministers. The Panel could, if required, have an on-going role of monitoring HIF performance, and reporting to Ministers.

b. *Independent Expert Assessors* – engaged by the MBIE HIF Unit to provide detailed assessments of proposals, and advice to the Panel.

c. *MBIE HIF Unit* – a dedicated commercial unit supporting the work of the Panel, and providing financial analysis, contract negotiation and management services, ongoing monitoring of HIF projects, and liaison between councils and Government. The Unit could include NZTA officials, and would be responsible for discussing funding terms with councils.

d. *NZTA* – would approve proposals that qualify for NLTF funding, and work with the Panel and HIF Unit to discuss funding terms with councils. The NZTA would be responsible for the ongoing administration and management of transport infrastructure projects through existing NLTF mechanisms. NZTA would have written funding agreements with each council.

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[3] The proposed governance model showing relationships is provided at Appendix Two.

Decision-making process for funding proposals

Previous decision

47 On 7 September 2016, EGI acting with Cabinet's authority of Power to Act, gave *in principle* agreement to the decision-making process for final proposals, with confirmation to be sought from Cabinet in October 2016. This was to allow time for the NZTA Board to consider the proposed arrangements.

Requirements under the Land Transport Management Act 2003

48 Under the LTMA, decisions on the use of the NLTF (including the setting of FAR) rest with the NZTA Board or approved delegates. The approval of projects qualifying for payment from the NLTF is a statutorily independent function of the NZTA, and therefore there is no provision for NLTF decisions to be made by another Crown entity.

49 Under section 10 of the LTMA, either the NZTA or the Crown may borrow funds for the purpose of managing a national land transport programme. However, the NZTA may only borrow funds in accordance with section 160 of the Crown Entities Act 2004, which requires the joint approval of the Minister of Transport and Minister of Finance. There is no provision for other Ministers to make these decisions.

Revised decision-making process

50 Due to these legal and procedural requirements, a revised version of the process has been developed by MBIE and NZTA officials, consistent with the process agreed to *in principle* by EGI on 7 September 2016.

51 The revised process provides for NZTA's involvement in relevant steps of the assessment process, and 'arm's-length' independent decision-making on proposals to be recommended to Ministers.

52 The main changes to the previous process are:

a. The NZTA Board is now required to approve proposals that qualify for NLTF funding (meeting LTMA requirements), prior to the Panel's consideration.

b. The Panel has sole responsibility for recommending an *in-principle* combined programme of proposals, for both water and transport projects, to the Ministers of Finance, Transport, and Building and Housing, and seeks their agreement for funding terms to be discussed with councils.

c. Following discussions, the Panel agrees to a final programme of proposals and funding terms.

d. Ministers agree to a programme of works, based on the final programme of proposals, and associated funding terms recommended by the Panel. This recognises that Ministers will make final decisions on the drawdown of HIF funds for water projects, and through the Crown loan to the NLTF, have the capacity for HIF transport projects to be funded.

53 I am therefore proposing that the decision-making process be (a summary of the revised process is at Appendix Three):

a. the Panel and NZTA officials evaluate final proposals against the Housing Infrastructure Fund eligibility and assessment criteria;

b. as part of the evaluation process, the NZTA carry out quality assurance checks against National Land Transport Fund criteria to ensure transport projects can be funded through the National Land Transport Fund;

c. the NZTA Board approves eligibility for NLTF funding for supported proposals (for some projects this may be *in-principle* support at this stage);

d. the Panel agrees to an *in-principle* programme of proposals;

e. the Panel provides the *in-principle* programme of proposals to the Ministers of Finance, Transport, and Building and Housing, and seeks their agreement for funding terms to be discussed with councils;

f. the HIF Unit, including NZTA officials, discusses funding terms with councils. The NZTA is to agree to terms for transport projects, and the Panel then agrees to the combined water and transport programme and funding terms;

g. the Panel provides the final programme of proposals and funding terms to the Ministers of Finance, Transport, and Building and Housing, who then agree to a programme of works;

h. the Minister of Finance and Minister for Building and Housing jointly approve borrowing HIF funding for water projects, and the Minister of Finance and Minister of Transport jointly approve the NZTA to borrow from the HIF for transport projects, as per LTMA requirements; and

i. drawdown of HIF funding is managed as per borrowing arrangements between the Treasury and the Ministry of Business, Innovation and Employment for water projects, and between the Treasury and the NZTA for transport projects.

NZTA Board consideration of the decision-making process

54 On 10 October 2016, the NZTA Board considered the proposed funding and decision-making arrangements to utilise the NLTF for financing transport infrastructure components of HIF projects.

55 The NZTA Board has expressed a willingness for the NZTA to work closely with MBIE to ensure a seamless delivery of infrastructure. The Board has confirmed its support for required changes to the Government Policy Statement on Land Transport 2015-18 (GPS 2015) to facilitate the HIF's use of the NLTF funding mechanism. The Board also endorsed the use of adjusted FAR to front-load councils' transport projects, enabling councils to invest in their share of the transport infrastructure within ten years of the NZTA drawing down on the HIF loan.

56 The NZTA Board considered the earlier decision-making processes for evaluating final proposals, as agreed *in principle* by EGI on 7 September [EGI-16-MIN-0228], and subsequently revised by MBIE and NZTA.

57 The NZTA Board has endorsed that decision-making process. They noted however that accountability for delivery of the HIF programme is not as straightforward as under the NZTA's traditional investment approach. This is due to the NZTA Board not being party to final decision-making on the HIF programme. Therefore, it must be ensured that only transport projects that the NZTA Board has agreed can be funded through the NLTF, are included in the final programme of recommended proposals. The NZTA Board outcomes are provided at Appendix Four.

58 It is my view that the subsequent changes to the decision-making process contained in this paper that accommodate the Panel's role in assessing proposals are consistent with the NZTA Board's previously expressed views. However, for certainty, I will seek the NZTA Board's endorsement of the revised decision-making process following Cabinet's decisions.

Changes to the Government Policy Statement on Land Transport 2015-18

59 To enable the NLTF to be utilised for HIF projects, amendments to the GPS 2015 are required. This is to allow HIF 'lead' projects to be given appropriate priority for the distribution of funds through the NLTF. Amendments to the GPS 2015 would also provide clear signals to councils and relevant land and transport planners.

60 A separate Cabinet paper from the Minister of Transport addresses requested changes to the GPS 2015.

Assessment criteria

Adding a 'lower-cost housing' assessment criterion

61 I propose that a 'lower-cost housing' criterion be added to the existing nine assessment criteria to evaluate and compare final proposals. Specifically, '*the number of lower-cost dwellings expected to be built as a result of the funded infrastructure*'.[4]

62 While it is not considered prudent to add an obligation for HIF-supported developments to contain a proportion of lower-cost housing, this criterion would require councils to directly address this factor in their proposals.

Why a requirement to include a proportion of lower-cost housing is not mandatory

63 Officials have advised that in terms of impacting on housing affordability, the HIF is expected to have only an indirect or marginal impact on house prices in the short-term, and a direct impact in the medium-term.

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[4] The definition of 'lower cost housing' would be consistent with established measures for affordable housing, such as KiwiSaver HomeStart price caps.

64 The primary objective of the HIF is to overcome short-term funding constraints experienced by high-growth councils, and through this, enable more rapid releases of serviced, developable land. The release of additional sections is expected to have a dampening effect on housing prices overall, thereby increasing the number of ‘affordable’ homes.

65 The most important factor in encouraging downward pressure on the cost of developable land is to provide an increased supply of serviced land with minimal development constraints. A requirement for there to be a proportion of lower-cost housing in developments would add a development constraint that could:

a. encourage a developer to increase the purchase price of land of other sections to recoup the cost of providing ‘affordable’ housing;

b. see the developer choose to delay development to either increase the chance of a greater return at a later date; or

c. stall developments entirely by making them unviable (as has occurred recently with some affordable apartment developments in Auckland).

Assessment framework for final proposals

66 In September 2016, Cabinet agreed to nine assessment criteria [EGI-16-MIN-0228]. An assessment framework has been developed by MBIE officials, following consultation with the Treasury, NZTA and the Department of Internal Affairs (DIA) (see Appendix Four). This framework provides the Panel with guidance for assessing and selecting proposals to recommend for HIF funding.

67 I recommend the assessment framework outlined in Appendix Five be adopted as a draft guiding document for the Panel.

68 Refinements to this framework may be required following consideration of indicative proposals, and Cabinet decisions on repayment periods. The finalised assessment framework will be included in the Call for Final Proposals, due to be announced in late January 2017.

69 For the agility of policy decisions as the HIF moves into the implementation phase, I seek agreement to delegate authority to the Minister for Building and Housing to make any further decisions on technical changes required for the Call for Final Proposals process, and to the Ministers of Finance, and Building and Housing for decisions relating to financial matters, and in both cases, consistent with the policy intent agreed to by Cabinet.

Consultation

70 This paper was developed in consultation with the Treasury, Ministry of Transport, Department of the Prime Minister and Cabinet, DIA, and the NZTA. The State Services Commission was consulted on establishing a Crown entity.

71 MBIE officials consulted council officials on the HIF process in July and August 2016. Councils contacted were Auckland Council, Hamilton City Council, Tauranga City Council, Christchurch City Council, and Queenstown-Lakes District Council. A workshop was held with councils, the LGFA and agency officials in early November to discuss funding options for water infrastructure.

Councils' concerns with proposed timing for final proposal submissions

72 Target councils have expressed concern with meeting the planned deadline of 31 March 2017 to submit final proposals, if they are to use the special consultative procedure under the LGA and build a robust and competitive case for funding. These councils have suggested that alignment with standard LGA planning cycles would be preferred.[5]

73 Despite this concern, the current timeframe for receiving proposals will facilitate the earliest possible implementation of HIF projects to accelerate housing development.

Funding and repayment arrangements

74 As mentioned earlier, several councils have expressed concerns with their ability to repay HIF funding within ten years. However, the proposed funding arrangement to provide interest-free funding for ten years addresses two of the HIF's objectives – assisting councils to deal with their short-term funding constraints; and providing an incentive to accelerate the supply of housing.

75 s 9(2)(ba)(i), s 9(2)(f)(iv) [redacted]

Risks

Cost over-runs for major infrastructure projects

76 Major infrastructure projects still in the development phase can underestimate cost contingencies. Projects when progressed to the construction phase can exhibit cost over-runs, and such over-runs can become more pronounced in projects brought forward to an earlier commencement date.

77 Councils will be asked to clearly identify any contingency amounts in their final proposals, so that this cost component can be considered by the Panel. I expect the Panel to address whether there is a need for a portion of the $1 billion HIF to be retained as a contingency measure to help manage potential cost over-runs, in its report on recommended proposals.

[5] For example, the Annual Plan cycle for most councils is likely to be run from March to June 2017.

Financial Implications

Impact on capital allowances

78 Under the Fiscal Management Approach (FMA), capital expenditure that is repaid or recovered within a 10-year timeframe is treated as fiscally neutral. s 9(2)(f)(iv) [redacted]

79 For transport infrastructure, the NZTA has stated that requests for drawdowns of HIF funds by NZTA would be dependent on written council agreement to cashflow adjustments through reduced FAR funding within ten years of HIF funding drawdown. This provides a high level of assurance that funds will be recovered and repaid to the Crown by the NZTA within ten years, and therefore that the funding would be treated as fiscally neutral.

80 For water projects, certainty over the repayment schedule would allow a project to be treated as fiscally neutral. Consideration as to the degree that funding neutrality is likely to be achieved will not be possible until indicative proposals have been received in December 2016. The funding mechanism requires a degree of flexibility over the timing of repayments, and therefore the Government carries the risk that funding will not be fiscally neutral.

MBIE funding

81 Funding of $0.7 million was approved for MBIE to establish the Fund and HIF structures, through a fiscally neutral adjustment (FNA) within Vote Building and Housing at the October Baseline Update 2016.

82 I am seeking a further FNA within Vote Building and Housing of $0.7 million in 2016/17 to establish an Independent Assessment Panel and a supporting commercial unit within MBIE as shown below:

	$m – increase/(decrease)				
Vote Building and Housing	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21 & out years**
Departmental Output Expense: Weathertight Services (funded by Revenue Crown)	(0.700)	-	-	-	-
Multi-Category Expenses and Capital Expenditure: Policy Advice and Related Outputs MCA:					
Departmental Output Expense: Related Services to Ministers – Building and Housing (funded by Revenue Crown)	0.700	-	-	-	-

83 The Panel and HIF unit will assess proposals and negotiate agreements with councils; manage and monitor the application of the Crown's investment, and the repayment of Crown funding; and monitor and report to Ministers on achievement of policy outcomes. Specialist skills including commercial acumen will be required in undertaking these functions.

84 s 9(2)(f)(iv)

[redacted]

Recognition of fiscal risks

85 The Public Finance Act 1989 requires the disclosure of circumstances that may put pressure on the forecast spending amounts, and/or have a material effect on the fiscal outlook. Final bids for the HIF are not expected to be received until late March 2017 and decisions are yet to be made about water infrastructure governance and loan arrangements. There is a high level of uncertainty in the areas noted below which may have additional fiscal impacts that need to be managed. The following have been disclosed as specific fiscal risks for consideration by the Minister of Finance:

a. The split between capital and operating spending which will impact fiscal indicators (currently the Fund has been reflected as capital expenditure in the forecasts);

b. Whether the full amount of the Fund will be repaid to the Crown;

c. For the amount that is repaid, when the repayment will occur.

d. Whether market interest rates would be applied to any portion of the HIF loan.

86 A further risk is the cost of the concession, which will be affected by judgements on the terms of interest-free loans.

s 9(2)(f)(iv)

[redacted]

88 s 9(2)(f)(iv)

Delegation to Ministers to create new appropriations

89 The appropriations required to implement this policy for the Ministry of Transport (transport infrastructure) and MBIE (water infrastructure) will not be known until responses to the Call for Final Proposals have been assessed, and agreement reached on successful proposals.

90 I therefore seek agreement to delegate authority to establish appropriations to joint Ministers of Finance and the respective Vote Minister (Transport or Building and Housing) once the split between water and transport infrastructure, and phasing of funding is known.

91 Multi-year appropriations will be sought as projects are likely to spread across financial years.

Human Rights, Gender implications, Disability Perspective

92 None.

Legislative Implications

93 None.

Publicity

94 I recommend that this Cabinet paper be proactively released, with material redacted consistent with the principles of the Official Information Act 1982, in the interests of transparency and to inform target councils of further detail of the implementation of the HIF. In particular, to inform councils of the agreed assessment criteria and framework, and the preferred water infrastructure funding mechanism. This will assist councils in the preparation of their final proposals.

Recommendations

The Minister for Building and Housing recommends that the Committee:

1. **note** that a Call for Indicative Proposals to access Housing Infrastructure Fund funding was made on 22 September 2016, with the Call closing on 2 December 2016;

2. **note** that some councils have stated they may be discouraged from applying for Housing Infrastructure Fund funding, despite the interest-free nature of funds, as existing high levels of debt could potentially lead to credit rating downgrades and consequent higher overall interest payments;

Transport funding mechanism

3. **note** that transport infrastructure is proposed to be funded through the National Land Transport Fund using adjustments to the Funding Assistance Rate;

4. **agree** that the Ministers of Finance, Transport, and Building and Housing be authorised to make further decisions in relation to the transport funding mechanism should an alternative to the proposed Funding Assistance Rate approach be required;

Water infrastructure funding mechanism

5. **agree** that the preferred mechanism available to provide Housing Infrastructure Fund funding for water infrastructure is *subordinated debt* – where a council recognises a debt obligation subordinate to bank debt; and with any residual amounts to be paid at the end of the loan term;

6. **agree** that the preferred form of repayment of Housing Infrastructure Fund loans for water infrastructure be according to a schedule from drawdown;

7. **agree** that any further decisions on variations to this funding mechanism be delegated to the Ministers of Finance, and Building and Housing;

Timing for repayment of Housing Infrastructure Fund funding

8. **note** the decision of the Economic Growth and Infrastructure Committee of 7 September 2016 that there be an expectation of NZTA or council repayment of Housing Infrastructure Fund funding within ten years, rather than an obligation;

9. **agree** that an extension of the loan term beyond ten years is only to be considered where a council can provide details of their fiscal situation that indicates a longer repayment term is required to benefit from the HIF, and that any outstanding balances after ten years would ordinarily incur interest at standard commercial rates;

10. **note** that any extension in the repayment period beyond ten years for transport infrastructure would require the agreement of the NZTA Board;

Exemption from interest for extended repayment timeframes

11. **agree** that that, due to the potential impact on Crown budget allowances, any council request for an exemption from interest on loan balances after ten years, which may also apply (with the NZTA Board's approval) to the loan from the Crown to the NZTA, would require the approval of Cabinet;

Ownership of water infrastructure assets

12. **agree** that ownership of water infrastructure funded through the Housing Infrastructure Fund is to be vested immediately with the relevant territorial authority;

HIF governance model

13. **agree** that the Housing Infrastructure Fund governance model consist of:

    13.1. the Independent Assessment Panel (the Panel) – to be appointed by Ministers, with expertise in governance, infrastructure development, and financing;

    13.2. *Independent Expert Assessors* – to provide detailed assessments of proposals, and advice to the Panel.

    13.3. a Ministry of Business, Innovation and Employment HIF Unit – a dedicated commercial unit supporting the Panel, and providing financial analysis, contract negotiation and management services; and

    13.4. the New Zealand Transport Agency (NZTA) – managing transport infrastructure projects through the National Land Transport Fund;

Decision-making process

14. **agree** that the decision-making process for final proposals incorporate the following steps:

    14.1. Panel and NZTA officials evaluate final proposals against the Housing Infrastructure Fund eligibility and assessment criteria;

    14.2. as part of the evaluation process, the NZTA carry out quality assurance checks against National Land Transport Fund criteria to ensure transport projects can be funded through the National Land Transport Fund;

    14.3. the NZTA Board approves eligibility for NLTF funding for supported proposals (for some projects this may be *in-principle* support at this stage);

    14.4. the Panel agrees to an *in-principle* programme of proposals;

    14.5. the Panel provides the *in-principle* programme of proposals to the Ministers of Finance, Transport, and Building and Housing, and seeks their agreement for funding terms to be discussed with councils;

    14.6. the HIF Unit, including NZTA officials, discusses funding terms with councils. The NZTA is to agree to terms for transport projects, and the Panel then agrees to the combined water and transport programme and funding terms;

    14.7. the Panel provides the final programme of proposals and funding terms to the Ministers of Finance, Transport, and Building and Housing, who then agree to a programme of works;

14.8. the Minister of Finance and Minister for Building and Housing jointly approve borrowing Housing Infrastructure Fund funding for water projects, and the Minister of Finance and Minister of Transport jointly approve the NZTA to borrow from the Housing Infrastructure Fund for transport projects; and

14.9. drawdown of Housing Infrastructure Fund funding is managed as per borrowing arrangements between the Treasury and the Ministry of Business, Innovation and Employment for water projects, and between the Treasury and the NZTA for transport projects;

NZTA Board considerations

15. **note** that on 10 October 2016, the NZTA Board endorsed:

15.1. the use of the National Land Transport Fund as a funding mechanism for the transport components of HIF; and

15.2. the revised decision-making process for final proposals provided in this Cabinet paper (conditional on the formation of a special purpose vehicle), which is based on the previous process agreed to *in principle* by EGI on 7 September [EGI-16-MIN-0228];

16. **note** that subsequent adjustments to the decision-making process, incorporating an Independent Assessment Panel, remain consistent with the NZTA Board's decisions of 10 October 2016;

17. **note** that I will seek the NZTA Board's endorsement of the revised decision-making process;

Assessment framework for final proposals

18. **agree** that '*the number of lower-cost dwellings expected to be built as a result of the funded infrastructure*' be added as an assessment criterion against which final proposals will be evaluated and compared;

19. **agree** that the assessment framework provided in Appendix Five of this paper be used as a guide for the assessment of Housing Infrastructure Fund proposals by the Independent Assessment Panel;

20. **note** that refinements to the assessment framework will be developed in preparation for the release of the Call for Final Proposals in early 2017;

21. **agree** that the Minister for Building and Housing be authorised to make any further decisions on technical changes to the Call for Final Proposals process, including refinements to the assessment framework;

22. **agree** that any further decisions relating to financial matters for the Call for Final Proposals process be delegated to the Ministers of Finance, and Building and Housing;

Potential for cost over-runs

23. **note** that I will expect the Independent Assessment Panel to address whether there is a need for a portion of the $1 billion Fund to be retained as a contingency measure to help manage potential cost over-runs, in its report on recommended proposals;

HIF financial and funding arrangements

24. **note** that a fiscally neutral transfer within Vote Building and Housing at the October Baseline Update for 2016/17 has been approved to meet the cost of establishing the Housing Infrastructure Fund, and a secretariat function within the Ministry of Business, Innovation and Employment;

25. **agree** the following fiscally neutral adjustment to provide for the establishment of the Independent Assessment Panel and HIF Unit, with no impact on the operating balance:

	$m – increase/(decrease)				
Vote Building and Housing	**2016/17**	**2017/18**	**2018/19**	**2019/20**	**2020/21 & out years**
Departmental Output Expense: Weathertight Services (funded by Revenue Crown)	(0.700)	-	-	-	-
Multi-Category Expenses and Capital Expenditure: Policy Advice and Related Outputs MCA:					
Departmental Output Expense: Related Services to Ministers – Building and Housing (funded by Revenue Crown)	0.700	-	-	-	-

26. **agree** that the proposed changes to appropriations for 2016/17 above be included in the 2016/17 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;

27. s 9(2)(f)(iv) [redacted]

Recognition of fiscal risks

28. **note** the high level of uncertainty in the areas detailed below constitute fiscal risks for consideration by the Minister of Finance:

    a. the split between capital and operating spending which could impact fiscal indicators (currently the Fund has been reflected as capital expenditure in the forecasts);

    b. whether the full amount of the Fund will be repaid to the Crown;

    c. for the amount that is repaid, when repayment will occur; and

    d. whether market interest rates would be applied to any part of the HIF loan;

s 9(2)(f)(iv)

[redacted]

Delegation to Ministers to create new appropriations

30. **note** that until the form and structure of the Crown's assistance to territorial authorities has been determined, there is uncertainty surrounding the nature and scope of funding and appropriations needed to implement this policy;

31. **agree** to delegate to joint Ministers of Finance and the respective Vote Minister (Transport or Building and Housing) the authority to establish the appropriations required to implement the policy decisions agreed in this paper;

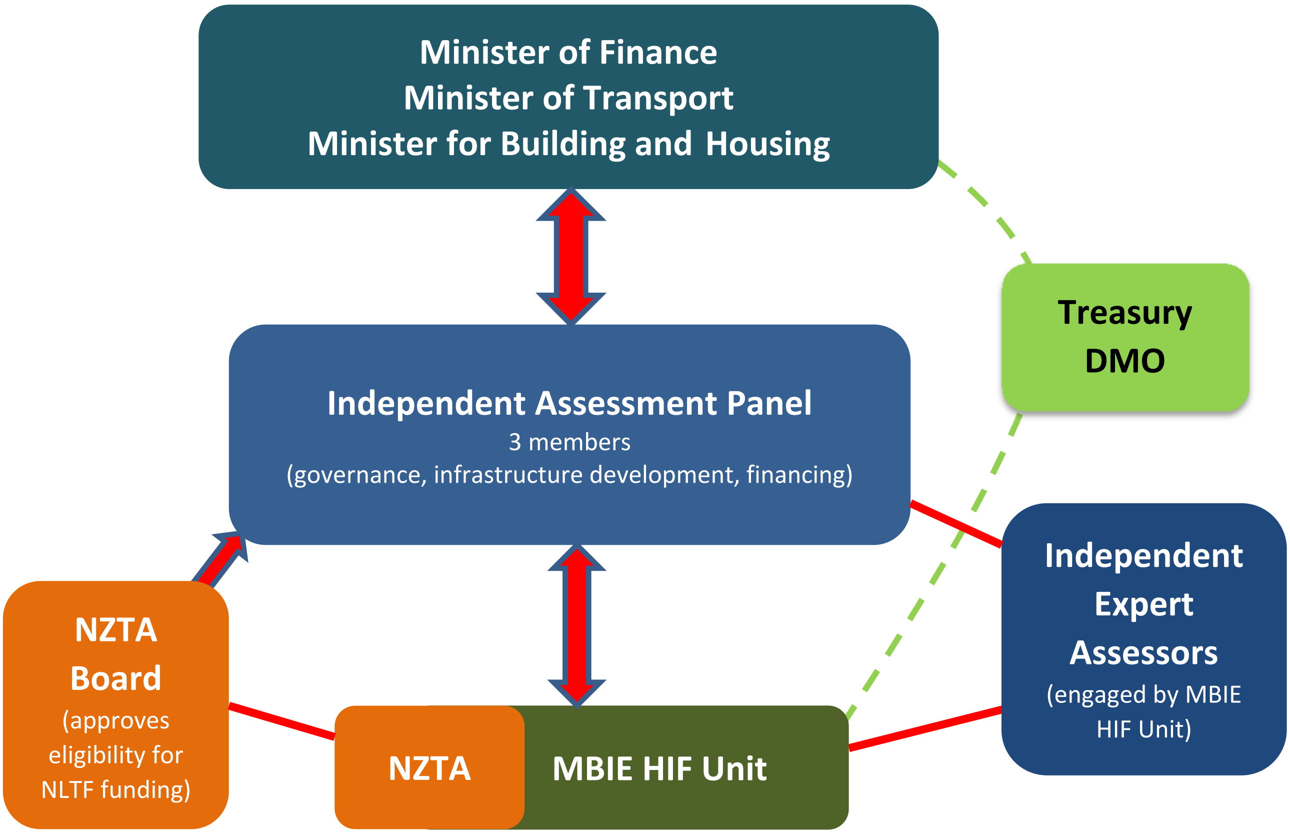
32. **note** that the split between Vote Transport, and Building and Housing, will be determined once responses to the Call for Final Proposals have been assessed, and agreement reached on successful proposals;

Publicity

33. **agree** to the proactive release of this Cabinet paper, with material redacted consistent with the principles of the Official Information Act 1982.

Hon Dr Nick Smith
Minister for Building and Housing

Appendix One: Proposed governance model



Appendix Two: Water funding mechanisms eliminated from consideration

1 *Option exercisable by council to buy assets* – this option gave no assurance that the Crown could recoup its investment, as the council could continue to utilise the asset without paying for its capital cost, and the Crown would have no alternative purchaser of the assets;

2 *Charges levied by a special purpose vehicle, using council as the collection agent* – advice has indicated this arrangement would be unlikely to be viable, due to Local Government Act 2002 (LGA) requirements for councils to retain control and responsibility for the provision of water services; and

3 *Sale of infrastructure assets built by the Crown under the HIF* – it would be unlikely that the Crown could recover its costs in selling a depreciated asset in an uncompetitive market (the only viable purchaser being the relevant council), and the initial Crown ownership would also likely to be contrary to the LGA.

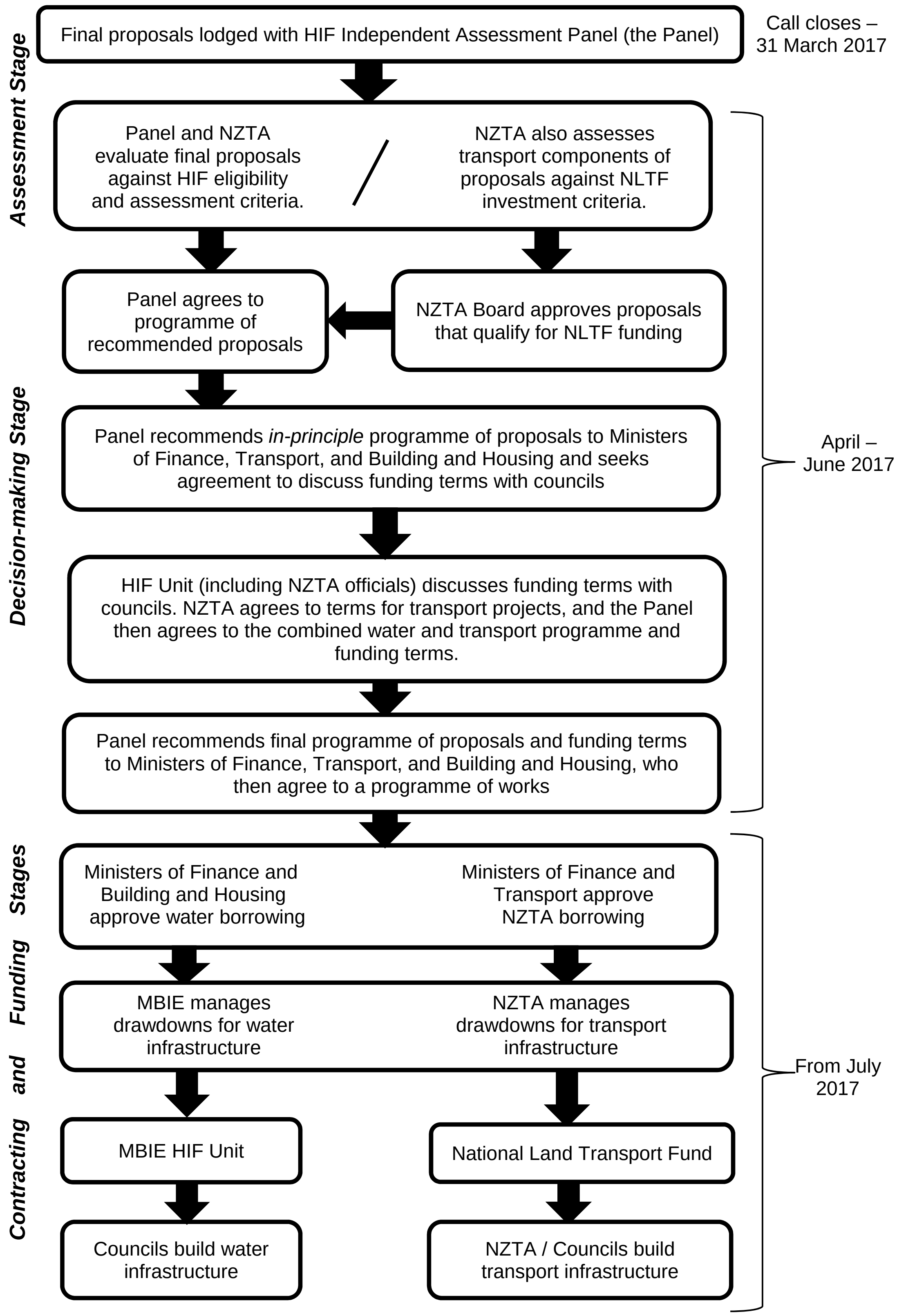
4 *Government-Council joint venture with uncalled capital* – while this mechanism may balance risks between councils and the Crown, the establishment of a parent Crown entity and related joint venture companies would be an expensive, complex and time-consuming mechanism to establish and operate, especially given the level of funds expected to be used for water infrastructure.[7] In addition, the use of joint ventures would have to be either:

   a. controlled by the relevant council, which would result in increased risk to the Crown of recovering its investment in a timely manner; or

   b. controlled by the Crown, which could be contrary to LGA requirements, and negate any debt treatment benefits for councils.

[7] Recent feedback from councils is that water infrastructure is expected to account for approximately $250-350 million of the $1 billion HIF.

Appendix Three: Revised decision-making process for HIF funding



s 9(2)(f)(iv)

Appendix Five: Proposed assessment framework

The assessment criteria are ranked in order of importance below. To assist its assessment work, the Independent Assessment Panel (the Panel) may also develop its own scoring and weighting values aligned with these rankings, to provide an early indication of favoured proposals. As part of its assessment, the Panel should also take into consideration:

- The cost to Government if the expected repayment period is beyond ten years;
- Construction capacity and integration with other major infrastructure projects; and
- The level of confidence the Panel has in the project going ahead as proposed.

Assessment priorities (in order of importance)

1. Number of dwellings as a proportion of total projected demand
2. Expected timing of dwelling construction
3. Infrastructure spend per dwelling
4. Level of developer commitment to accelerating development
5. Council commitment to removing barriers to development
6. Degree to which timing of infrastructure construction will be brought forward
7. Period within which the Crown is expected to recoup its investment
8. Degree to which other investments or economic growth would be supported
9. Level of lower-cost housing[8]
10. Degree to which NPS-UDC[9] targets are met by the proposed infrastructure

[8] If this criterion is agreed to by Cabinet.
[9] National Policy Statement on Urban Development Capacity.