

FINANCIAL INSTRUMENTS AND FUNDING

Government interests

1. In November 2010 Ministers agreed [CAB Min (10) 39/14 refers] on the features that the Auckland spatial plan will need to have in order to better enable government support. Amongst these was the need for the spatial plan to be affordable and feasible; to complement central government funding and decision-making processes; to seek to maximise value from existing infrastructure investments and networks rather than focusing on new spend; and to emphasise the role of demand management and efficient pricing in order to reduce costs, shape behaviours and manage growth.
2. At one level these issues would appear to relate more to the implementation of the Auckland spatial plan than to its content and strategic objectives. However, funding and implementation issues are integral to the content of the plan and also for the management of central government's interests in the plan because:
 - demonstrable affordability, practicality and achievability will be critical factors in obtaining buy-in to the plan from all stakeholders, including central government, and from the public generally;
 - affordability, both absolute and at particular times, is likely to be a key criterion for the inclusion and timetabling of infrastructure and service delivery initiatives that arise from the plan;
 - a sustainable and broadly accepted funding strategy will be critical to successful implementation of the plan, and its successors, on an ongoing basis; and
 - any expectations about new Government funding will need to be carefully managed to ensure they do not negatively affect the relationship between the Auckland Council and central government, and thus the ability to deliver an integrated and effective growth strategy for Auckland.
3. The Auckland spatial plan provides an opportunity for the Auckland Council to develop and adopt smarter, fit-for-purpose funding tools and financial instruments to support the objectives of the spatial plan. A key rationale for the establishment of the new Auckland Council was to create a local authority that could plan for and implement its strategies and investment priorities.
4. It also provides an opportunity for Government agencies to improve their planning on the location and sequencing of infrastructure and services in Auckland. This will improve their asset management and investment decisions in line with current best-practice expectations and within current funding constraints.

Current situation and trends

Central government's fiscal position

5. Central government is moving from a stimulatory to a more neutral fiscal position, containing spending within allowances designed to secure a return to fiscal surplus in 2014/15, and ensuring that net Crown debt remains under 40 per cent of GDP and is brought back to prudent levels (20 per cent of GDP) by early 2020s.
6. This fiscal strategy will support balanced and sustainable economic growth by reducing pressure on monetary policy and allowing more resources to flow towards private sector activities, thereby helping reduce economic vulnerabilities.

However, adopting this strategy means that many current policy settings and service levels are unaffordable over the medium to long term.

7. Fiscal consolidation does not mean that the Government will stop investing. The \$1.39 billion capital allowance set aside for Budget 2011 and signalled for future budgets until 2014 is in addition to the \$36 billion¹ the Crown is already committed to investing in physical assets such as roads, school, hospitals and other essential assets required for delivery of government services up to the end of the 2015 fiscal year. Over this period the total value of the Crown's asset base is forecasted to increase to approximately \$256 billion. Much of this investment will be in Auckland. One rough estimate shows that Auckland received 37 per cent of the Government's new capital investment in the 2009 year.²
8. Both the National Infrastructure Plan and the Government's recent 2010 Investment Statement outline what the fiscal strategy means for infrastructure and capital investment. In brief, there will be a constrained budget for quite some time, and for the foreseeable future many agencies that invest in Auckland will not receive any additional capital funding beyond that already earmarked but still have to ensure services are delivered. This means that:
 - **Agencies will be expected to do more with less** and the incentives for better use of existing capital will be sharpened. From an infrastructure perspective this means that agencies will be expected to optimise the use of existing assets and networks, and reduce the need for future investment through the use of pricing and other demand management instruments (which can also assist in revenue security), find new and innovative ways of improving service provision (including through alternative procurement models such as public-private partnerships) within existing funding levels, introduce private sector capital and disciplines where appropriate, manage assets better over their whole life, provide more transparency around asset performance, dispose of surplus assets, and recycle (reprioritise) capital.
 - **Agencies will be expected to be much smarter about the new investments they make** and will be expected to prioritise capital to its highest value use. The Government will set a high hurdle for business cases to justify new capital, and has published Better Business Case guidelines to support this policy position. The guidelines encompass the need for a strategic case for investment (including investment logic mapping), and a two-stage (indicative and detailed) business case process that emphasises economic cost-benefit analysis, exploration of alternative procurement methods, accounting for whole of life costs (not only operating costs, but also wider social costs) and the synergies that can result from alignment with other investment decisions and strategies (including land-use strategies).
9. In addition, the Government is taking a strategic approach to better managing the Crown's overall balance sheet. This will involve looking for ways to get better value out of the Crown's commercial portfolio, sharpening incentives on agencies to use Crown capital well, and more actively reprioritising capital to higher value uses. The recent decision to explore the possibility of extending a mixed-ownership model to four state-owned enterprises and reducing the Government's shareholding in Air New Zealand is evidence of this new focus.
10. While the current fiscal environment necessitates a focus on value optimisation, prioritisation and balance sheet management, it is not exclusively coupled with it;

¹ "2010 Investment Statement of the Government of New Zealand" 14 December 2010, p.80.

² NZIER. (2010). *Central Government Expenditure in Auckland*.

it is simply good policy. That is, the focus will be enduring irrespective of the future condition of the Crown's balance sheet.

Auckland Council's fiscal position

11. The Auckland Council operates within the same economic environment as central government, and faces similar constraints as a result.
12. The Council has a strong asset base (\$32.4 billion), relatively modest debt as a proportion of total assets (\$3 billion), and significant annual operating expenditure of around \$1.8 billion. Funding is projected to be sourced largely from general and targeted rates (62.8 per cent), with a further 13.1 per cent coming from fees and charges and 6.8 per cent from development contributions. Borrowing is forecast to provide 10.8 per cent of funding over the period 2011-2019.³
13. Auckland Council Investments Limited (ACIL) is a new council-controlled organisation established to hold and manage Auckland Council's major investment assets, including most prominently the Council's shareholdings in the Ports of Auckland Ltd and Auckland International Airport Ltd. Based on the information currently available, ACIL manages total investment assets currently worth \$1.195 billion (\$881 million net) and is forecasting to return a dividend to the Auckland Council of \$25 million in 2011/12. This represents an approximate 2.8 per cent dividend yield.⁴
14. Public expectation is likely to create considerable pressure on the Auckland Council to constrain future rates increases. This fact, combined with an aspirational spending programme signalled by the Mayor (e.g. new capital investments in a CBD rail loop, airport rail link, waterfront development, etc), means that the Auckland Council will have to make difficult decisions about prioritising its expenditure, how it manages its capital assets and balance sheet, and how it funds its spending programme. Given the Crown's fiscal position and investment policies, the reality is that the Government cannot always provide support for major Auckland projects, even if there is a positive investment case.

Future directions

15. The Auckland Council faces a number of distinct pressures. These include the need to replace the disparate funding, accounting and asset management systems inherited from the eight previous councils with integrated systems that are fit for purpose for the future. Apart from the major policy issues inherent in designing robust and enduring systems, there will be significant challenges in anticipating, understanding, and managing the transition process and its impacts.
16. In the context of funding systems (e.g. rating and development contributions policies) in particular, this will involve dealing with legal and equity obligations generated by previous practices as well as a range of stakeholder and public expectations. Significant tensions will arise between changes that are publicly and politically acceptable (in terms of measures such as relative increases in liability in individual cases) and achieving funding arrangements that are coherent and equitable across Auckland, and sustainable into the future.
17. A funding strategy that is demonstrably realistic (i.e. affordable) and politically sustainable will, however, be an important prerequisite to stakeholder and public buy-in to the Auckland spatial plan, as well as to its actual implementation.

³ Auckland Council Long Term Plan 2010-2019.

⁴ Ibid.

18. In addition to managing the tension between new objectives and legacy-based transition issues, it will be important that the funding strategy is consistent with and supports the objectives of the Auckland spatial plan. Local authority funding mechanisms such as rates and development contributions, as well as prices for goods and services generally, can have significant spatial characteristics. It will be important that these are used, not just to maximise revenue but to reflect the true costs of locational and behavioural options and choices in support of spatial plan objectives.
19. Resolving competing pressures and tensions through the development of an integrated funding approach/strategy will be a major technical challenge that will inevitably take the Auckland Council several years to complete. Introducing new funding policies will also have a political dimension for the Auckland Council.
20. While central government agencies can offer technical assistance during this process if required, the debate on funding policies needs to occur between the Auckland Council and its ratepayers and other stakeholders.
21. These funding and financing issues are, however, of concern to central government because:
- the efficiency and effectiveness of funding arrangements, in terms of spatial plan objectives and in the wider context, will impact on the future development of the Auckland and national economies;
 - the ability of Auckland Council to effectively fund its spatial plan initiatives will impact on both Council and stakeholder expectations of central government funding; and
 - an effective and appropriate funding strategy will also assist to target and prioritise central government contributions to the funding of joint outcomes.
22. The Government recognises the magnitude and difficulty of the task Auckland Council faces in developing its overall funding strategy and policies. The Government will encourage and support this occurring as quickly as is realistically possible, without compromising the quality or political and fiscal sustainability of the outcomes. This task will require a much longer period of development than the first Auckland spatial plan.
23. Because the Auckland spatial plan is being developed to inform the Auckland Council's long-term plan, the Government's position on the spatial plan can help inform the Council's funding and investment strategies.

Government's current position

24. Building on the discussion above, and to inform the Auckland Council's development of its spatial plan, the following offers a Government position on the following key aspects:
- Government funding of initiatives and investments derived from the spatial plan; and
 - Auckland Council's approach to funding spatial plan initiatives, and other expenditure.

Government funding

25. Affordability and practicality need to be key criteria for assessing the plan's strategic objectives, as well as key infrastructure and service delivery initiatives. The Auckland spatial plan needs to be realistic about Government's contribution to its objectives.
26. The Crown's fiscal position and strategy means there is unlikely to be additional central government funding for delivering on Auckland's strategic aspirations (beyond that already signalled for investment), and even where there is, the Government will be very careful about what it chooses to invest in. Agencies will be seeking to get better value out of existing investments, and to prioritise investment to the highest-value use. The strategic case for central government funding or intervention will receive particular attention.
27. The Government will be in a better position to support an Auckland spatial plan that acknowledges and reflects these realities. The more it does this, the more likely that central government can and will help Auckland deliver it through its own decision-making. It can do this by requiring agencies to use the spatial plan to inform the sequencing and location of Government-funded infrastructure and services in Auckland over time.
28. The Auckland spatial plan will not alter the fundamentals of how central government budgets for or makes investment decisions, but it can help improve the outcomes from existing investment processes. It should be an important input into the strategic and business case development for all central government capital investments in Auckland.
29. Government policy is for all its investments to deliver much better outcomes over time. The Auckland spatial plan provides a coordination and information-sharing tool for helping deliver better outcomes, by ensuring that agencies' investment decisions are strategically aligned (where possible, and where appropriate) with each other and with local government and private sector infrastructure investment and land-use decisions. It can help inform planning of the optimal sequencing and location of Government-funded infrastructure and services in Auckland and demonstrate where infrastructure aspirations that are not affordable now may become more economic in the future.
30. Using the Auckland spatial plan in this way is consistent with the Government objective of improving agencies' asset management and investment decision-making processes. Ministers will expect Government agencies, as part of good decision-making and business case development, to factor the Auckland spatial plan into their own investment decisions and strategies where appropriate. Exactly how that occurs needs to be worked out at the sectoral/delivery level, and will vary according to each agency's investment process.
31. In addition, there will likely be opportunities for Government to adjust its own strategic priorities and policies in response to evidence and perspectives arising from the spatial plan, and from discussions with the Auckland region. Government's strategic spending decisions should always be informed by the best available evidence, and there is opportunity for the processes around the spatial plan to bring new and useful evidence to light.

Auckland Council funding and financial instruments

32. The Auckland Council faces similar fiscal constraints to the Government, and so it would also make sense for the Council to consider new and innovative approaches to funding and financing the infrastructure and services required to deliver Auckland spatial plan objectives.
33. The immediate focus of the Auckland Council will be on completing the significant transition tasks that remain. The governance reforms do, however, provide the Auckland Council with an excellent opportunity to:
- review the current use of regulatory instruments that distort price signals and oppose the preferences of Aucklanders; and
 - develop and adopt smarter, fit-for-purpose financial instruments to support Auckland's spatial plan objectives.
34. An efficient and enduring urban form (including maintenance of housing affordability) will require much smarter shaping of behaviours involving the use of market- and incentive-based tools, efficient and flexible pricing of infrastructure and service delivery, demand management, and private sector participation.
35. This can occur within existing legislative scope (which is already very broad and enabling), but over time may require some changes to legislation. The Government will be open to assessing proposals for such changes on their merits.
36. For example, there are a number of funding and financing tools available to local government that could be better utilised to meet these objectives:
- Targeted rates or more negotiated, partnership-based value uplift capture mechanisms (such as Tax Increment Financing or land readjustment tools) can be used to better link the costs of infrastructure investment in specific areas with the benefits enjoyed by property owners. For example, property owners can coordinate to aggregate their land for a higher-density development, offering up a share for public-benefit infrastructure and/or amenities that serve to significantly raise the value of their remaining land-holdings.
 - Development contributions can be used to shape development choices by making the true costs of growth in different areas more transparent (and ensuring that certain forms of development are not effectively subsidised). For example, developers may choose to invest in an area ear-marked for growth in the spatial plan if they can share in some of the savings associated with coordinated infrastructure investment (because the infrastructure investment that would have been required elsewhere is no longer).
 - More accurate and targeted pricing of infrastructure and services can help ensure that people's behaviours and locational choices are fully-informed and reflect people's true cost-adjusted preferences.
 - Public-private partnerships and private capital, where appropriate.
37. The development of the Auckland spatial plan therefore needs to be accompanied by careful consideration of what funding arrangements will best achieve its desired outcomes, in terms of imposing the appropriate costs on appropriate parties at the appropriate time. This will then provide a framework for assessing the ability of existing mechanisms to achieve or approximate these conditions and indicate where modified or additional funding tools may be justified.

38. The Government will also be exploring opportunities to leverage management of its own asset base to this effect, and has signalled as much in the *National Infrastructure Plan*. In addition, the Government will be examining the Crown's balance sheet to determine whether capital can be reprioritised to higher-value uses. Ideally the Auckland Council would not preclude a similar undertaking from its overall funding and financial strategy, as a way of potentially re-allocating resources towards the achievement of the spatial plan's objectives.

39. While we encourage the Auckland Council to explore and develop new and innovative approaches to funding infrastructure and services, the Government is aware that there are a number of reasons why expectations of a rapid acceptance of proposals for new or significantly changed mechanisms need to be tempered:

- The use of the Auckland Council's taxation, development contribution, and borrowing powers are constrained by transparency and accountability mechanisms, rather than by objective tests of affordability or statutory limits. The provision of new or significantly modified funding mechanisms is likely to involve significant impacts on accountability arrangements and will not be able to be undertaken lightly or quickly.
- Different funding mechanisms involve different collection mechanisms and timing, different incidence of legal liability and different flow-on effects within that economy. New mechanisms would need to have clear advantages, in terms of one or more of these aspects, if they were to be justified. It is unlikely that this could be demonstrated immediately, given the current lack of clear information about either the Auckland economy or the economic 'footprint' of different funding mechanisms.
- The development of an integrated funding approach requires the balancing and resolution of tensions between competing objectives and expectations, and has a high political component. There is a significant risk to the benefits of a coherent and effective strategy arising from public and media pressure to minimise or avoid significant increases in costs or liability for any sector or individual, irrespective of the justification for the proposed change.

40. The inherent difficulty of the task does not negate its necessity. In the medium to long term, it is necessitated by the fiscal position faced by both levels of government, by best-practice investment decision-making and capital asset management policy, and by the need to complement the spatial plan with effective and fit-for-purpose implementation tools.