SIMPSON GRIERSON

Funding the Future

Reviewing New Zealand's infrastructure funding & financing toolkit

November 2024

01

Introduction

New Zealand faces significant challenges in funding and financing infrastructure.

The need for investment in robust infrastructure – spanning transportation, utilities, housing, water, climate resilience, digital networks and other sectors – has escalated dramatically. We need to invest in new infrastructure to support growth, guard against new pressures such as climate change, and renew the critical, but now ageing, infrastructure delivered in the infancy of our nation.

The New Zealand Infrastructure Commission | Te Waihanga (Te Waihanga), estimated in its "Infrastructure Strategy 2022" a need for around NZ$ 110 billion in infrastructure investment over the coming decade.

But the key question remains – how will we pay for it? It's a question we must tackle in order to reap the many benefits that infrastructure can deliver – including economic growth, a resilient environment, and enhanced living standards.

Currently, New Zealand allocates about 2.5% of its GDP to infrastructure investment, a level that has stagnated since 2012. Academic commentators have indicated that this figure should ideally be closer to 3.5% to adequately address future needs.

Traditional 'socialised' funding mechanisms, including central government budgets and local council rates, are becoming increasingly inadequate in the face of the investment required. Many local councils, particularly those that are experiencing high growth, also face significant financial constraints, with a number already approaching their borrowing limits.

Unfortunately, there are no silver bullets. To overcome this challenge, it is critical that we modernise and broaden the funding and financing tools available and allow agencies to implement flexible strategies to unlock new sources of revenue and capital. For each project, we must fairly answer the question of who should pay, and how?

It is therefore welcome that, under the banner *Improving Infrastructure Funding and Financing,* the New Zealand Government is working on a programme to more smartly and equitably fund and finance infrastructure.

With 2025 looming large as a crucial year for delivery, we review the Government's work programme, and comment on the key issues and tools that need to be addressed.

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Funding vs Financing: There are only three funding sources

While commentators often talk about our "funding and financing" challenges – it is important to recognise that this now common phrase consists of two entirely separate concepts – "funding" and "financing".

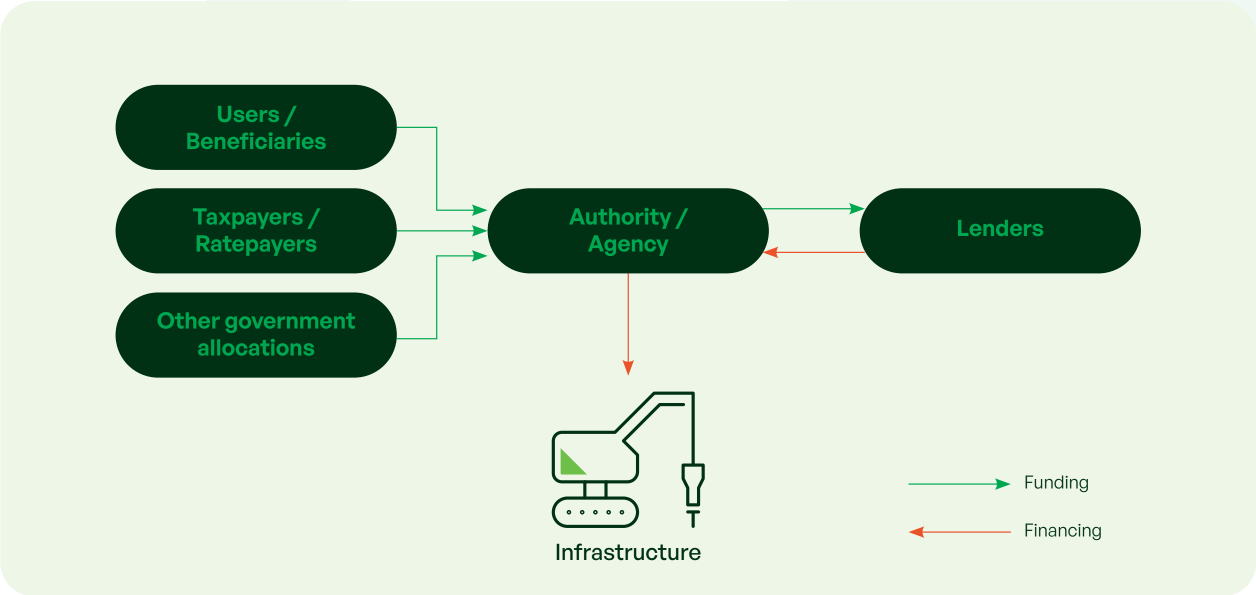
The recognition of these different concepts leads to a new question – do we have funding challenges, financing challenges, or both?

Financing refers to the upfront capital needed to begin and complete an infrastructure project. It's essentially a way to borrow money that will be paid back over time - such as through bonds, loans, or equity investment.

Funding, on the other hand, refers to the long-term revenue sources used to pay for an infrastructure project, including by repaying the financing.

Funding

First, let's consider funding. There are only three sources of funding – user/beneficiary charges (paid for by users and other beneficiaries of infrastructure), rates and taxes (paid for ratepayers and taxpayers) and other government allocations (eg from asset recycling or other budgets).



How infrastructure is ultimately paid for, and by whom, is determined by its funding sources. Financing is only an upfront, or temporary, arrangement.

This is the case even when private financing is involved. Consider the case of a new transport project, to be "funded" from the National Land Transport Fund (NLTF) (itself made up of various funding sources – including contributions from users through Fuel Excise Duty, Road User Charges and registration and licensing fees).

If the project is procured traditionally by an agency, the availability (or otherwise) of funding will dictate whether the agency involved can afford to pay for the capital costs (including public borrowings) of the project. If the project is procured with private finance (such as under a Public Private Partnership (PPP)), the availability (or otherwise) of funding will still dictate whether the agency involved can afford to pay for the capital costs of the project (including borrowings) – albeit serviced through an availability payment (or similar) payable to the party that raised the private finance.

This underscores the reality that all infrastructure costs are ultimately borne by the public, either as taxpayers, ratepayers, or users. The choice between these funding sources involves trade-offs in terms of equity, efficiency, and political acceptability, but does not escape the fundamental need for society to fund the infrastructure it uses.

> ***New funding tools may shift where the burden of cost sits, but the overall economic base remains the same."***
>
> *Minister for Infrastructure, Hon Chris Bishop*

Financing

Generally speaking, where adequate funding is available, finance (whether public or private) for otherwise viable projects should follow. Lenders and investors will commit capital to infrastructure projects where their investment can be serviced and returned.

While there are some opportunities at a systemic level to improve our ability to attract capital, and some particular financing constraints that need to be grappled with (for example, local council borrowing limits), attracting and raising finance does not present a major challenge in New Zealand – provided that funding is available.

Ultimately, the availability and robustness of the funding stream is what makes finance available.

So, when it comes to addressing our "funding and financing" challenge, it's clear that our primary focus should be on solving the *funding* question. With a small population of approximately 5.1 million and a comparatively large land mass, the task will not be easy – we do not have a large base to spread the funding burden across. But that is a challenge we must take up – including by finding new ways to equitably spread the burden to those who benefit most from the infrastructure delivered.

03

Improving Infrastructure Funding and Financing: the Government's work programme

Earlier in 2024, the Government released details of a new work programme, aptly titled "Improving Infrastructure Funding and Financing" (IIFF Programme).

Central and local Government have (with some exceptions, such as the NLTF) historically funded infrastructure from taxes and rates. Speaking at the 2024 Building Nations Conference, Alistair Birchall, Head of Balance Sheet & Transactions at The Treasury, discussed that, while taxes and rates can be an appropriate source of funding for some forms of infrastructure, this approach has resulted in three significant challenges:

- funding settings that do not manage investment demand or signal where investment is required;
- funding models that do not reflect the full economic cost of delivering services; and
- insufficient tools or incentives to deliver infrastructure in advance of growth.

These challenges contributed to system level issues – an infrastructure deficit in excess of NZD$100billion and low levels of efficiency in infrastructure investment (near the bottom 10% of high-income countries). It is these issues that the IIFF Programme is seeking to address.

On the funding side, the core element of the Government's programme is to shift more explicitly to a 'beneficiary pays' model for infrastructure funding. Where possible, the funding used to support investment should come from those who benefit from it.

> ***If beneficiaries are not prepared to pay, and there are no compelling social or broader economic benefits, then the rationale for investment should be re-examined."***
>
> *Alistair Birchall, Head of Balance Sheet & Transactions, The Treasury*

A beneficiary-pays approach also reduces pressure on the Government's balance sheet, and preserves capacity for those investments where it is more appropriate for the Government to be the primary funder.

The shift towards a beneficiary –pays model will be generated by:

- a more strategic and informed approach by the Government as to when and how it uses its balance sheet to fund infrastructure (including mandatory consideration of beneficiary-pays funding); and
- critically, broadening and enhancing the funding tools available to both the Government and local councils.

With 2025 looming large as a crucial year for delivery, in the following pages we review some of the core planks of the Government's work programme, and comment on the key issues and tools that need to be addressed.

IIFF Programme timeline

2024

June 2024

Transport: Policy advice provided on time of use charging

July 2024

Regional Deals: Cabinet paper endorses framework and governance of RDs

August 2024

Public private partnerships: Advice on modernising Crown's approach to PPP procurement

September 2024

Principles that guide the Crown's rationale and approach to the provision of funding and/or financing finalised

LGFA reform: Advice on enabling greater lending flexibility for water infrastructure through the LGFA

2024/2025

November 2024

Value-capture framework: Advice on reform options due

Infrastructure funding settings: Cabinet decisions on how policy options could address issues with current growth funding tools (development contributions and targeted rates)

December 2024

Council incentives: Policy advice on options to improve council incentives for growth (including sharing GST from developments and land protection options to lower infrastructure costs)

Transport: Advice on enhancing tolling settings, including legislative changes required to enable increased and more effective tolling

IFF Act reform: Cabinet decisions due

Early / Mid 2025

Regional Deals: Cabinet approval to be sought to initiate negotiations on first RDs

Delivery

04

Reviewing the Toolkit

Our five key messages for Government

1

An expansive toolkit is needed.

No one single funding tool will solve our funding challenges. We need multiple funding tools in the toolkit - so that the right tool can be used for the right project. Investment in new tools to complement existing funding tools should be prioritised.

2

Funding tools must be simple and workable.

If funding tools are overly complex, they may not be used, or may be applied conservatively. This has been the experience with development contributions.

3

Funding tools must be bankable.

If finance is to be raised on the strength of a funding source, the funding source must meet financiers' requirements. Involve financiers in the design process.

4

Allocate the burden equitably.

In a time of economic pressure, seeking more funding for infrastructure will be challenging. Affordability is a real constraint. We must navigate that challenge by finding ways to allocate the funding burden to those who benefit and can afford to pay.

5

Stack the funding sources.

A shift towards user / beneficiary-pays models should be pursued. But not all infrastructure can be funded solely by its users and other beneficiaries. Those funding sources must therefore be capable of being used as part of a broader funding stack.

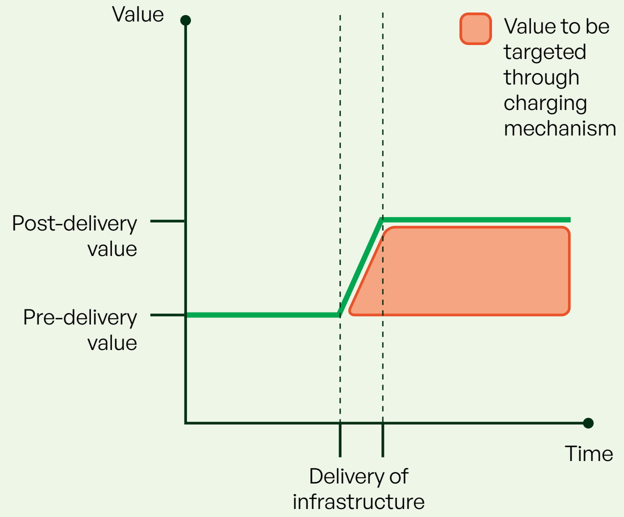
Value Capture

One of the key workstreams under the IIFF Programme is the development of a value capture framework.

A value capture framework is a funding and financing mechanism used to fund public infrastructure projects by capturing the increase in property values that results from those projects. When infrastructure such as transportation is developed, this can enhance the accessibility and desirability of surrounding areas, which in turn can increase property values.

At its simplest, value can be directly captured where an agency itself owns land surrounding an infrastructure project. This form of value capture does not require legislative support and is already used in New Zealand – particularly in relation to transport projects. What is needed to unlock greater value, though, is a value capture tool that does not rely on ownership.

Under the Local Government (Rating) Act 2002, local authorities can already use targeted rates as a property-based funding tool. However, while a targeted rate can be assessed on rateable values, it cannot be assessed on a *change* (ie an increase) in rateable values – and therefore is not directed at capturing *new* value.



At a conceptual level, there is much to like about value capture. Those who receive 'windfall' benefits from public infrastructure procurement should contribute some of that windfall. But there will be challenges to be addressed prior to its implementation in New Zealand:

- **Project selection:** not all projects can, or should, be eligible for a value capture charging framework. The provision of infrastructure that delivers core services (such as water and waste water networks) will be unlikely to generate any material value uplift. Transport projects and community facilities, on the other hand, may. Consideration should be given to which projects are to be subject to value capture (and how that value should be captured) in the design of the framework.
- **Value calculation:** how should the 'value' be calculated? Value capture models used abroad, such as Tax Increment Financing (TIF) rely on a baseline (day 0) values being set for properties, with an increase against that baseline after delivery of the infrastructure used as the basis for assessing a 'cents-in-the-dollar' charge. But consideration must also be given to how other externalities that may affect value are accounted for.
- **Equity vs cashflow**: while property values may have increased from the availability of new infrastructure, this does not mean an owner has additional cashflow to service a value capture charge. The availability of a financing mechanism which accesses that equity may also be needed in order to make value capture affordable.
- **Finance:** will a value capture framework in New Zealand be used as a cost recovery mechanism only, or as a revenue source that can also be leveraged to raise finance to invest in infrastructure on the strength of the revenue? If the latter, certainty of the revenue (or at least an ability to accurately model the revenue over time) will be desirable.
- **Legislation:** what is the best means by which to introduce a value capture charge? An amendment to the Local Government (Rating) Act 2002 and/or the Infrastructure Funding and Financing Act 2020, or bespoke value capture legislation? The answer may depend on which agencies are to have access to the framework.

Overall the most critical issue will be to ensure the framework is workable and has utility in the New Zealand context. It does not need to be perfect – all we need is somewhere to start.

Infrastructure Funding and Financing Act

The infrastructure levy model enabled with the passing of the Infrastructure Funding and Financing Act 2020 (IFF Act) has already been used on two successful pathfinder projects – contributing to the funding of the Western Bay of Plenty Transport Systems Plan projects and the capital's new Sludge Minimisation Facility at Moa Point.

Under the IIFF Programme, the Government is to review its use on those pathfinder projects and consider how the IFF Act can be refined for even greater use.

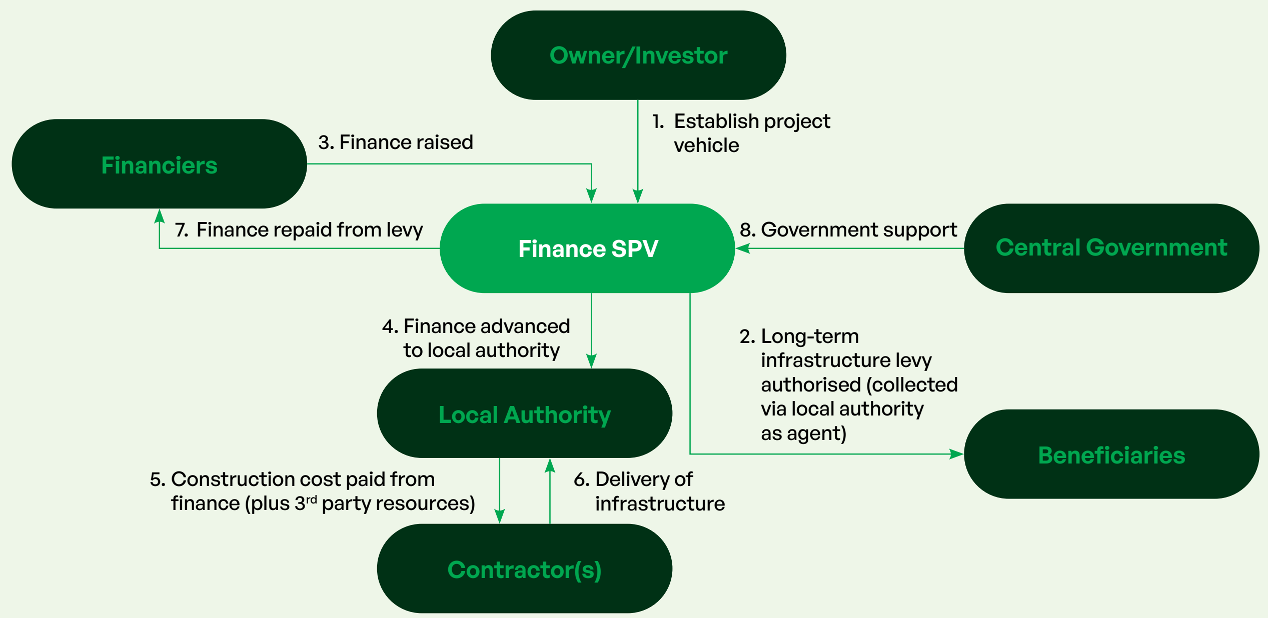
IFF Act model

Councils are responsible for delivering infrastructure such as water infrastructure and roading but are subject to maximum debt levels. These borrowing constraints can lead to postponements in investment in viable infrastructure projects, including the infrastructure needed for new housing developments.

The IFF Act model was designed to enable these projects to be funded and financed outside of these debt constraints. In order to achieve that, the model provides for the establishment of standalone special purpose vehicles (SPVs) which can borrow to pay for the upfront costs of the infrastructure, instead of the council. The SPVs will repay the borrowings by charging a levy to those who benefit from the infrastructure (for example, landowners in the area serviced by the new infrastructure).

While enabled by bespoke legislation, the IFF Act model has inherent flexibility:

- It can be used for a range of infrastructure (including water, transport, community and environmental resilience infrastructure).
- SPVs can be responsible for the construction of the infrastructure (and the IFF Act provides them with a number of powers to facilitate this). Or, SPVs can just be responsible for funding and financing the infrastructure, with the borrowings provided to another party (eg the local council) who will be responsible for construction.
- It can be deployed in a greenfields setting (eg a new ring-fenced housing development area), a brownfields setting, or on a city-wide basis.
- It can, like rates, set charges based on a number of different charging methodologies (including uniform and differential charges).



Pathfinder projects

Tauranga - Transport Systems Plan

Tauranga was the first city to use the IFF Act model, with the enactment of the Infrastructure Funding and Financing (Western Bay of Plenty Transport System Plan Levy) Order 2022 (TSP Order) in November 2022.

The 30-year levy authorised under the TSP Order enabled an SPV to raise borrowings of approximately $175 million from private financiers – to be applied towards the construction costs of up to thirteen transport projects in Tauranga selected from the wider Western Bay of Plenty Transport System Plan.

As the Transport System Plan included a range of projects from across the city that will benefit Tauranga residents and business as a whole, the levy has been charged on all ratepayers in the city.

Wellington - Sludge Minimisation Facility

The second city to use the model was Wellington. Under the Infrastructure Funding and Financing (Wellington Sludge Minimisation Facility Levy) Order 2023 (SMF Order) a 33-year levy has been set which enabled an SPV to raise $400 million from private financiers for the capital city's new sludge minimisation facility at Moa Point.

As with the TSP Order, the SMF Order provides for all residential and commercial ratepayers in the city to pay the levy – as all will benefit from the new facility.

The IFF Act model has enabled councils that are subject to debt constraints to raise considerably more debt than they would be able to achieve through conventional means. For instance, by using an SPV, Wellington was able to borrow more per dollar of additional revenue than it would have been able to achieve if it borrowed a loan itself.

> **“**
>
> ***Taking into account council debt covenants, a council loan would have enabled Wellington to borrow a maximum of $2.80 for each additional dollar of annual revenue. By using an SPV under the IFF model, Wellington was able to raise $400 million against an average of $42 million in annual levy revenue - allowing for $9.40 for every dollar of additional revenue.”*** [1]

This was able to be achieved because an SPV's only debt constraint is the amount which financiers will lend to it. The IFF Act model also demonstrates the clear importance of solving the funding side of our funding and financing challenge.

> **“**
>
> ***If debt finance is matched by an increase in revenues, either through increased economic activity or a dedicated revenue stream from user charges on new infrastructure or increases in rates for example, then overall capital investment will increase in both the short and long term.”*** [2]

By matching a dedicated revenue stream with a single infrastructure project, the IFF Act model also supports greater transparency and accountability – beneficiaries of the project are more easily able to assess the true costs of the project and consider whether they are willing to pay for it.

1. New Zealand Infrastructure Commission / Te Waihanga: “Is local government debt constrained? A review of local government financing tools”
2. As above.

Review of the IFF Act Model?

Under the IIFF Programme, the Government has provided a clear signal that it would like to see the model continue to be deployed to support the tackling of our national infrastructure burden. In order to enable that, consideration should be given to:

- **Streamlined process:** streamlining the IFF Act model proposal process, in order to reduce the time and cost involved in using the model.
- **Greenfields projects:** how the model may best be geared to support funding and financing greenfields housing projects.
- **Standardisation:** on the strength of the pathfinder projects, standardising the model to enable use by a wider range of councils, and other parties such as developers.

> **"**
>
> ***I view reform of the IFF Act model to be crucial across our wider housing agenda and I'll have more to say about that soon."*** [3]
>
> *Minister for Infrastructure, Hon Chris Bishop*

3. Speech to the LGNZ Infrastructure Symposium - 14 June 2024.

Development Contributions

Another review of development contributions under the Local Government Act 2002 (LGA) is underway.

Development contributions are the key tool through which local councils pay for infrastructure to support urban growth. As New Zealand's population is projected to grow by 1.2 million people by 2050,[4] it's important that we have the right funding tools to pay for the urban development needed to support that population growth.

The purpose of development contributions, as stated in the LGA, is to enable territorial authorities to recover from those persons undertaking development a fair, equitable, and proportionate portion of the total cost of capital expenditure necessary to service growth over the long term.

Many territorial authorities would, however, take the view that development contributions have not met their intended purpose.

This concern has set the scene for a further review of development contributions under the IIFF Programme. In the June 2024 Cabinet Paper approving the IIFF Programme, the Government has noted that the way development contributions are designed and used can struggle to recover the full costs associated with the growth they aim to service. This can cause a reluctance by councils to utilise development contributions to their full potential, resulting in the general ratepayer, or the Crown, needing to subsidise infrastructure costs - or the infrastructure not being provided at all, resulting in poorly serviced development.

Accordingly, under the IIFF Programme, the Minister for Housing and Minister for Local Government are seeking advice on how development contributions and targeted rates can better recover the cost of growth from beneficiaries.

In our view, the reluctance by councils to utilise development contributions as intended has several root causes. These include:

- the complexity of the development contributions regime;
- the significant planning, financial, asset management and legal input required to produce a legally compliant development contributions policy that is able to survive a potential legal challenge. There have been several successful legal challenges to development contributions over the past 20 years;
- the associated difficulties in being able to accurately identify the extent to which the development community (as opposed to existing residents and businesses) creates the need for, and benefits from, particular capital expenditure, leading to conservative allocations of costs to the development community;
- the use of development contributions to fund infrastructure in advance of development leaves councils exposed to higher-than-expected financing costs, if development is slower than anticipated; and
- insufficient powers to recover unpaid development contributions (at least when compared to unpaid rates).

To address these issues, Te Waihanga has suggested[5] that the existing development contributions regime be standardised through a single legislative process, similar to national building standards. This would make it easier for councils to charge development contributions, reduce legal challenges, uncertainty, and cost. While it is unlikely that common charges would be introduced for all locations, a new model could introduce standardised calculation methodology for all local authorities to use.

> ***Local government development contributions are a good method of funding infrastructure, but a standardised process is needed."***
>
> *Te Waihanga, "Infrastructure Strategy 2022"*

4. Statistics New Zealand. "National Population Projections, by Age and Sex, 2020 (base)-2073 (database)." 2020.
5. https://tewaihanga.govt.nz/the-strategy/7-a-world-class-infrastructure-system-how-we-get-there/7-2-improving-funding-and-financing

Water Funding & Financing

Water funding

While councils across the country evaluate their structural options for the future delivery of water services, a key question remains – how will new water service providers charge for water services and infrastructure?

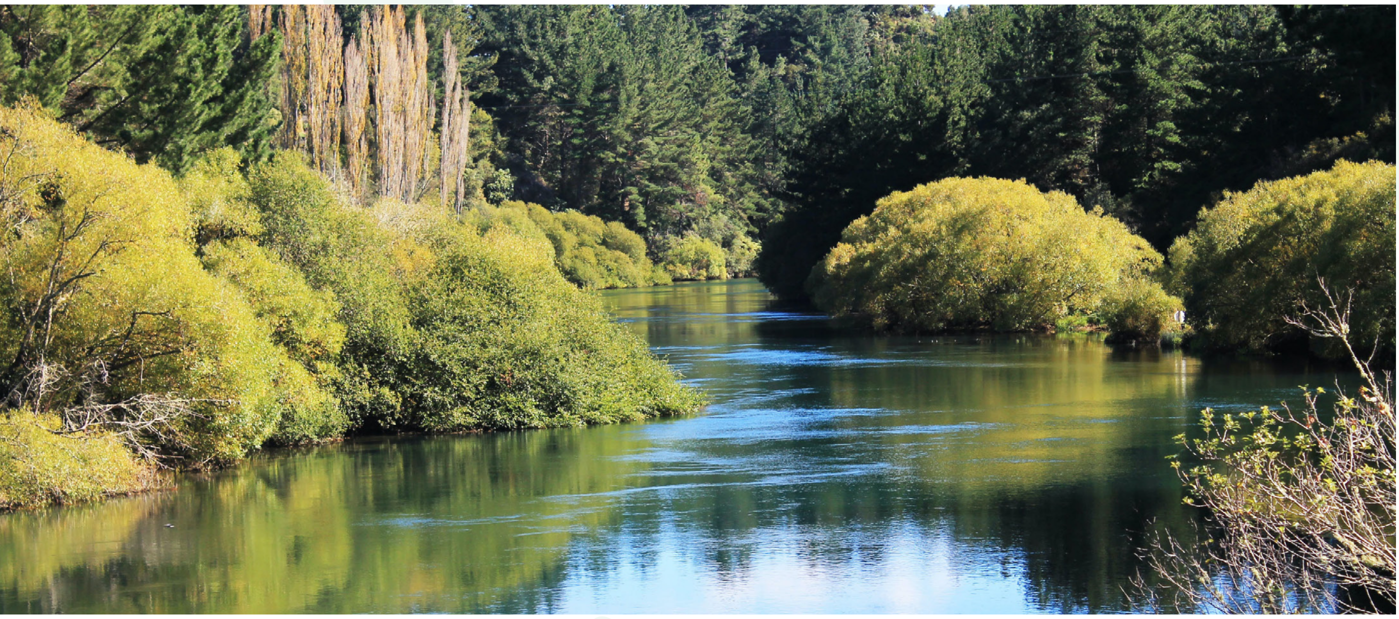
At present, water services and infrastructure provided by local authorities (either directly, or via council-controlled organisations (CCOs)) are generally funded by rates and development contributions, except in Auckland where Watercare funds its activities through contractual charges from its customers.

Contractual charges for services and infrastructure are in law no different from the power any other network utility operator has to set charges as per the customer contract. Because the charges are not statutory, they cannot be imposed on a customer who does not agree to pay them. However, in practice, the charges are paid because the customer wishes to receive the services. This contractual approach provides clear advantages in terms of flexibility.

On the other hand, two briefings from the Department of Internal Affairs[6] recommend the enactment of new legislation to empower boards of new (non-council) water service providers under Local Water Done Well to set statutory charges (where no customer contract is required). With the power of statute, such charges can often be backed by strong collection and enforcement powers.

There are therefore clear advantages to both the legislative, and non-legislative, approaches. In our view, both options should be available to water service providers across the country, allowing each provider to adopt a charging framework that best meets the needs of its community. It will be critical that any statutory charging regime does not override or limit a water service providers' inherent ability to contract with its customers.

Equally, the Government will need to be careful that any funding tools conferred by legislation are not accompanied by excessive prescription as to how charges are calculated. This could result in any new tools being under-utilised, as the experience with development contributions shows.

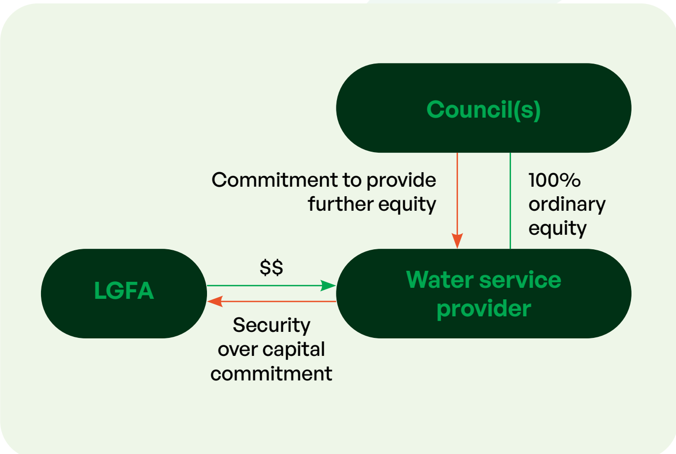


6. https://www.dia.govt.nz/diawebsite.nsf/Files/Proactive-releases-2024/$file/LG20241479-Water-service-delivery-vehicles-(18-Apr-24).pdf and https://www.dia.govt.nz/diawebsite.nsf/Files/Proactive-releases-2024/$file/LG20241948-Water-service-delivery-vehicles-pricing-and-charging-(16-May-24).pdf

Water financing

In addition to water funding options, councils and new water service providers will also need to grapple with the question of how to best raise finance for water services and infrastructure. The need to raise finance unrestricted by a council's borrowing limits is one of the key drivers for water sector reform.

In connection with the Local Water Done Well programme, the New Zealand Local Government Funding Agency (LGFA), partnering with central Government, Treasury and the Department of Internal Affairs, announced earlier this year that it will extend its existing lending model to new water organisations that are CCOs, provided the water CCOs are financially supported by their parent council(s) and can meet certain credit criteria. This financial support is expected to consist of a parent guarantee, or the issuance of 'uncalled capital' that is kept in reserve and may only be called on to support borrowings.



Under the new model, LGFA will support leverage for water CCOs up to a level equivalent to 500% of operating revenues - almost double the current level of existing councils at 285%. Borrowing by water CCOs will also be treated as separate from borrowing by parent council(s) – enabling one of the key drivers for structural reform. This is a change to LGFA's existing approach to CCO debt, where financial covenants are typically tested at the consolidated group level.

Through LGFA, it is expected that water CCOs will be able to access cheaper debt than would otherwise be available to them through alternative financing sources. By financing investments in water infrastructure through debt, the cost of the asset can be spread over its lifetime, reducing the up-front pressure on operating revenues. The use of water CCOs also allows councils to separate their revenue streams, meaning non-water services revenue streams can be kept for investments in non-water assets.

At this stage, LGFA has announced that this extended suite of lending will not be made available to water CCOs that are not financially supported by their parent council(s). For these water CCOs, access to additional debt financing to fund capital investment into water infrastructure will be largely dependent on the appetite of external, private financiers and the level of security the water CCOs are able to provide. However, LGFA has reported that it is also reviewing whether lending to water organisations on an unsupported basis may be possible in the future.

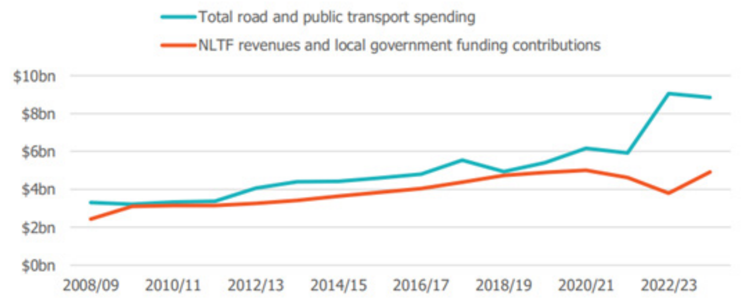
Transport Funding

Land transport infrastructure, comprising road, rail and public transport networks, represents more than 20% of New Zealand's total infrastructure investment (the largest single category).

Funding for land transport has traditionally been modelled on a user-pays philosophy, where revenues raised from transport users (such as petrol excise duty, road user charges (RUC) and registration and licensing fees) are funnelled into the ring-fenced NLTF to pay for transport system maintenance and development.

While it may be intended that the revenues raised from transport will cover the overall costs of transport infrastructure and services, the reality is that this is not the case. Research from Te Waihanga conducted earlier this year demonstrates that in recent years, transport investment has significantly exceeded revenues and the NLTF has not been able to keep up.

Figure 1: Road and public transport spending funded from current user charges, 2008/09-2023/24



Source: Te Waihanga analysis of Treasury annual Budget statements and NZTA NLTF reporting. 2023/24 local government funding contributions are not yet available and hence are imputed using 2022/23 data.

Under the IIFF Programme, the Government is prioritising its review of infrastructure funding and financing options for transport to assess how best to fill the gap.

New tools for transport?

There are three new tools that are under consideration as part of the Government's reform package:

- **Tolling:** Tolling is a user-pays funding method that directly links the use of the asset (ie the road) with payment for the use of the asset (ie the toll for using the road). Under the current legislative regime, only new roads may be tolled and funds raised from tolling may be used only for the construction, maintenance and operation of that new road.[7] As well as being a revenue collection tool, tolling has the benefit of managing demand on particular roads, as drivers use alternative routes rather than paying the relevant toll. While tolling has been utilised in New Zealand for some time, it has only been used relatively rarely. The Government has signalled that it sees tolling as forming an increasing share of New Zealand's transport revenue: this includes directing NZTA that it is expected to consider tolling to support the construction and maintenance of all new roads[8] and the Government identifying reform of the tolling regime as a priority within the Government's Land Transport Revenue Action Plan.[9]

7. Land Transport Management Act 2003, s 46(1)(a).
8. https://www.transport.govt.nz/assets/Uploads/Government-Policy-Statement-on-land-transport-2024-FINAL.pdf
9. https://www.transport.govt.nz/assets/Uploads/Proactive-Release-Cab-Revenue-Action-Plan-for-web.pdf

- **Time of use charging:** Time of use charging, by contrast, is a road pricing mechanism that seeks to maximise the use of existing assets by managing demand. At its core, it is a behavioural management tool. By more evenly spreading travel throughout the peak periods, this can defer or reduce the need for investment in new urban infrastructure (such as new road capacity) that would be utilised primarily during peak periods. That said, time of use charging will also generate revenue. The Government has signalled that revenues from any time of use charging scheme are to be used for land transport activities within the region in which charges apply and, importantly, are to supplement, rather than substitute for, NLTF funding or local shares of funding.
- **Fleet-wide RUC:** The government is considering a programme of works that would transition all vehicles onto a road user charges systems and away from the payment of fuel excise with a targeted date for initiating the transition of 1 April 2027. The revenue impact of this decision has not been made clear, but given the funding challenges faced in the New Zealand transport system, any transition would at the very least need to be revenue neutral.

A multi-faceted approach

The adoption of further tolling on new roads and time of use charging will be beneficial. Tolling of new roads can provide new revenue to support the construction and operation of new roads and more directly link the benefits of a road to its users. Separately, a greater number of toll roads will likely increase efficiencies in the administrative costs associated with operating these schemes. Time of use charging may also generate revenue, while also managing demand.

However, on their own, these tools will not be sufficient to fund the cost of major transport infrastructure. For example, Te Waihanga has identified three key factors that would be required for tolls to fully fund the costs of a given road:

- high traffic volumes;
- large travel time savings; and
- low construction cost.

However, research from Te Waihanga also indicates that, in practice, the revenue generated from tolling would cover less than 25% of the costs of most new roading projects. We simply do not have enough transport users to generate the income required to cover costs solely through a user-pays cost recovery model.

Rather than seeking to justify new investment in particular projects on the strength of these tools alone, our approach should be to use these tools to supplement our funding base at a holistic level. Ultimately, while these tools can each only make up one piece of the transport funding puzzle, they all provide opportunities to recover valuable revenue for projects where every dollar counts.

Asset Recycling

Given the challenges involved in establishing new funding sources, greater focus should also be placed on how we can access, or recycle, funding from existing investments.

The role of asset recycling has been acknowledged in the IIFF Programme, with the Government preparing revised guidance on its process for assessing unsolicited proposals for assets – a clear signal that the Government may be open to recycling non-core assets.

Asset recycling

Asset recycling is a strategy involving the sale or lease of existing public assets to the private sector, generating funding to reinvest in new public infrastructure.

This strategy can offer significant benefits in the context of infrastructure funding and financing:

- **Unlocking capital for new investments:** By leasing or selling mature and revenue-generating assets, it frees up public resources that can be reinvested into other infrastructure projects, and can also mitigate depreciation costs for existing assets. This is particularly important in light of Te Waihanga's *Build or Maintain?* report (released in February 2024[10]), which identified that between 2013 and 2022, depreciation costs for all types of infrastructure were equal to 58% of capital investment – that is, for every $10 spent on new and improved infrastructure, around $6 of existing infrastructure wore out.
- **Private sector efficiency:** Private operators often have stronger incentives to maintain and upgrade assets to ensure profitability and service quality, which can result in longer asset life and better services for users.
- **Risk transfer:** By transferring operational responsibilities to private entities, the Government can, where appropriate, also avoid certain financial risks involved in maintaining and upgrading assets during their lifespan.

Countries like Australia, Canada and the United Kingdom have successfully implemented asset recycling programs, providing instructive examples of how this model can transform public infrastructure funding.

In Australia, one notable example is the 50-year lease of the Port of Melbourne in 2016, which generated A$9.7 billion for the Victorian government. The funds were reinvested into Melbourne's transportation infrastructure, including the West Gate Tunnel and public transit upgrades. Similarly, in 2018 the New South Wales government sold a 50.4% stake in the WestConnex mortorway[11] for A$9.26 billion, and in 2020 confirmed that it would transact its remaining stake as well.These proceeds helped fund projects such as the Sydney Metro and other regional infrastructure development.

Clear public safeguards build confidence

While asset recycling is an attractive model for the Government with significant benefits, the loss of direct ownership and control needs to be met with appropriate safeguards. Addressing this issue head on in the Government's framework should help to manage not only the real risks involved, but also public perception.

For instance, the New South Wales government's lease of its electricity distribution assets was initially met with concerns about pricing increases and foreign ownership. These were addressed through various contractual stipulations relating to pricing caps, regulatory controls and composition of the company's board. Likewise, in Victoria, concerns about job losses at the Port of Melbourne were dealt with by implementing a two-year employment guarantee for all permanent non-executive employees.[12]

> **"*Asset recycling is not going to solve the infrastructure deficit by itself but will be an important tool to supplement traditional funding mechanisms and to make sure we are getting best value out of the resources we have.*"**[13]
>
> *Infrastructure NZ Position Paper: Asset recycling*

This for that

To make asset recycling credible and understandable as a funding source, divestment proposals should come with clear direction as to the specific assets that will be funded from the divestment proceeds. Public concerns with 'selling the Crown jewels' without getting anything tangible in return can be addressed if, as in the Port of Melbourne and WestConnex motorway examples, proposals involve a clear and direct appropriation of proceeds to new projects - allowing the public to make an informed decision.

10. https://media.umbraco.io/te-waihanga-30-year-strategy/djkmtwj4/build-or-maintain.pdf
11. https://www.premier.vic.gov.au/port-melbourne-lease-transaction-finalised
12. https://www.treasury.nsw.gov.au/sites/default/files/2020-11/Dominic%20Perrottet%20med%20rel%20-%20Westconnex%20transaction%20continues%20successful%20asset%20recyling%20strategy%20(002).pdf
13. https://infrastructure.org.nz/wp-content/uploads/2024/10/Infrastructure-NZ-Policy-Postions-Asset-Recycling.pdf

Regional Deals

Of interest to many councils will be the inclusion of Regional Deals in the Government's IIFF Programme.

The Government has been consistent in its message that the Regional Deals framework will not be a source of funding or financing for projects. How, then, might a Regional Deal be relevant to the improvement of infrastructure funding and financing under the IIFF Programme?

A recent market briefing prepared by the Department of Internal Affairs sheds some light on that issue.

While stating that "regional deals will not provide guaranteed funding for projects", the briefing also indicates that "potential options" for Regional Deals may involve both:

- the potential reallocation of existing government funding; and
- clear commitments to support identified infrastructure projects and the coordination of capital funding commitments.

This leaves open the possibility that Regional Deals may be a framework through which ordinary Government contributions (ie when the Crown considers the use of its balance sheet to be appropriate, in line with the principles developed under the IIFF Programme) are confirmed – rather than on an ad hoc basis.

The briefing also indicates that Regional Deals may involve a forum in which agencies can work together to unlock new funding and financing tools (with new user charges, value capture, targeted rates tolling, congestion charging, and an enhanced IFF Act all specifically mentioned).

This approach is to be welcomed, as any new funding tools for local government will need to be workable for, and meet the needs of, the local councils that will utilise them in the context of specific projects.

It also recognises that resolving our funding challenges may take some time, and parties will need to work together over the duration of a deal to continue to resolve funding constraints. With that in mind, any unresolved funding gaps should form part of the deal itself, with commitments from the stakeholders to work together in a joined-up partnership-based approach to identify funding challenges and solutions – including the development of new funding tools and sources where needed.

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