

Ministry of Transport: Aide Memoire

To: Hon Phil Twyford (Minister of Transport)
From: Helen White, Manager Investment
Date: 7 November 2019
Subject: Further information on base expenditure in GPS 2021
OC Number: OC191055

Purpose of this aide memoire

1. To provide a more detailed explanation of the processes we have gone through to model the base expenditure requirements for the Government Policy Statement on land transport (GPS) 2021. This summarises:
 - 1.1. how we have undertaken the budget-like approach
 - 1.2. our work with the NZ Transport Agency (NZTA) to estimate future expenditure levels
 - 1.3. the cost pressures on base expenditure activities
 - 1.4. what the base expenditure will achieve.

The budget-like approach — applying the Treasury's budget process to GPS 2021

2. At the beginning of the GPS 2021 development process, you requested that we approach the investment section and setting of activity class for GPS 2021 in a similar way to how the Treasury approaches the Budget process.
3. Treasury's approach to the Budget process generally considers Government spend under three categories.
 - 3.1. Current baselines (ongoing annual expenditure) — business-as-usual funding, which is generally at a fixed level, but from time-to-time the Government will seek to drive greater efficiencies in areas, for example, by requiring annual cost savings or through sector reviews.
 - 3.2. Cost pressures (increases in current baselines) — increases in usual spending to support increasing costs.
 - 3.3. New initiatives — new expenditure prioritise that seek to progress the Government's objectives.
4. We have used this approach to categorise the expenditure that is guided by the GPS.

- 4.1. The **baseline (or base) expenditure** that is required to deliver the current outputs including contracted and committed expenditure (such as projects underway or debt repayments). This includes a provision for input cost increases, given almost all output costs are driven directly by industry cost measures.
- 4.2. A case was required to seek increased funding to address **cost pressures** within base expenditure. These activities have a particular need for expenditure to increase above the level of industry costs to continue to deliver existing levels of service.
- 4.3. Any **new initiatives** are prioritised against each other to ensure funding is going to those priorities that best address the Government's objectives.
5. To initiate this approach, we worked with the NZTA to divide all expenditure from the National Land Transport Fund (NLTF) over 2021/22–2030/31 into a series of activities. This was typically in line with activity classes, but at a more granular level of detail.
6. This helped increase our confidence in the level of base expenditure, and the cost pressures facing that expenditure. It provides the ability to take active decisions to reduce levels of service in particular areas, and help understand if that could be an acceptable means to free up funding for other priorities.
7. The focus of this aide memoire is on the activities that form the base expenditure, and the cost pressures on those activities. The cover briefing (OC191098) provides detailed advice on the possible trade-offs to advance Government priorities (the "new initiatives" to be funded through discretionary funding).

Caveat to the budget-like approach

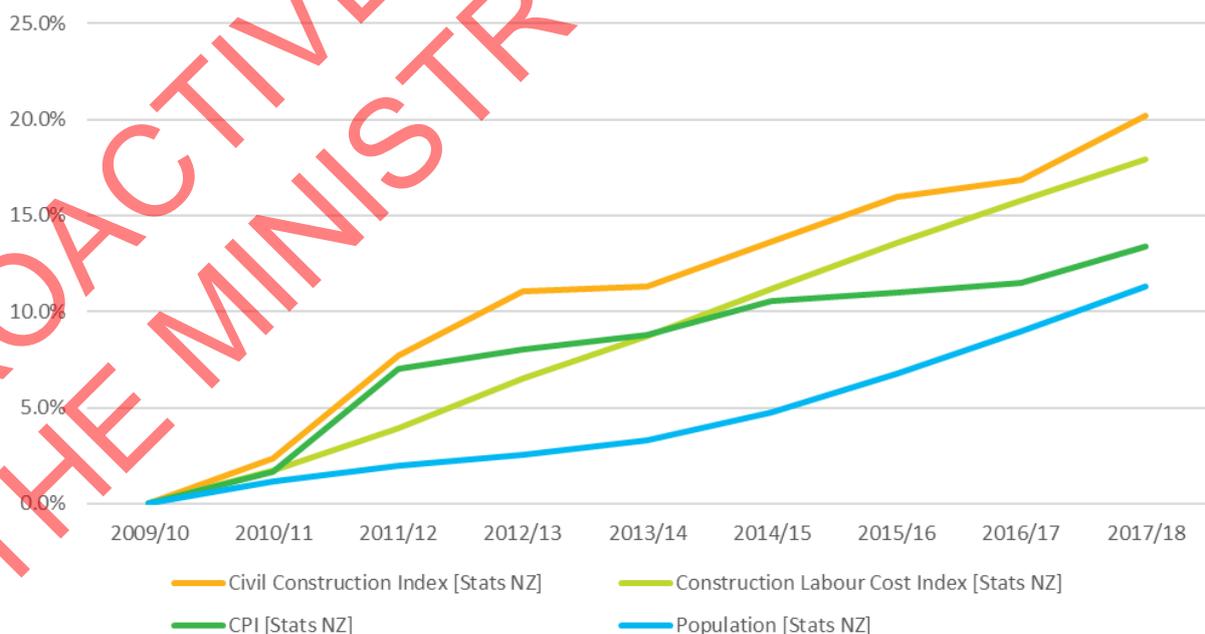
8. Expenditure through the National Land Transport Programme (NLTP) is determined by the NZTA in a way that gives effect to the GPS. It is not possible to estimate with perfect accuracy what expenditure/specific projects will be progressed under GPS 2021 until the NLTP is developed. Therefore, the estimates made as part of the budget-like approach are based on the forecasts for activities that the NZTA considers are likely to be considered as part of the NLTP.
9. Any increases or decreases above the base expenditure will be made at the discretion of the NZTA, in a way that is consistent with and gives effect to the GPS. We cannot accurately estimate the specific impacts of funding increases and decreases. Instead, the budget-like approach attempts to estimate how the NLTP could reflect funding increases and decreases.

The base expenditure is the required investment to keep the system running

10. In our previous advice (OC190953 refers) we advised you that \$35 billion (72 percent) of expenditure over the 10 years of GPS 2021 is required to fund the ongoing operation of the existing system. We have taken a strict view of this base to present the most accurate picture of the remaining discretion. We consider this expenditure to be non-discretionary, though some savings are possible if Ministers are willing to accept reduced levels of service to those that the network currently offers.
11. Base expenditure includes:
 - 11.1. contractual obligations (e.g. completing incomplete projects, PPP repayments) expected as at 30 June 2021

- 11.2. maintaining current output levels (e.g. road policing and public transport services)
- 11.3. maintaining and renewing existing assets (e.g. replacing end of life bridges)
- 11.4. additional public transport, road policing and asset maintenance investment to maintain levels of service and keep pace with growth.
- 12. The base expenditure does not include:
 - 12.1. improvement projects that are part of the Auckland Transport Alignment Project (ATAP), Let's Get Wellington Moving (LGWM) and Road to Zero, unless the projects are committed or expected to be committed by 30 June 2021
 - 12.2. costs to implement the Future of Rail, which the Government is looking to embed within the GPS/NLTF framework. The NLTF funding levels will depend on decisions taken around the split between Crown and NLTF funding
 - 12.3. any projects that will improve network levels of service.
- 13. Cost assumptions for most activities are aligned with the direction outlined in GPS 2018. We have considered cost pressures to be those activities where costs have increased relative to the cost estimates as at GPS 2018.
- 14. We have included standard industry cost increases as part of the base expenditure. The cost of delivering current outputs increases proportionately with industry costs.
- 15. For most base expenditure activities, the increase in expected cost of maintaining levels of service is around 2 percent per annum, which is broadly in line with long-term trends, and industry inflation indicators as included in previous advice (OC190772 refers) and shown in Graph 1 below.

Graph 1: Cumulative growth in economic indicators since 2009/10



We have not identified any obvious opportunities to reduce base expenditure without impacting levels of service

16. Any savings found in the base expenditure have the potential to increase the discretion available to progress other key priorities. However, given we have taken a strict view of the composition of the base, we have not identified any opportunities to deliver cost savings, unless you are willing to reduce current levels of service.
17. Reducing investment in the base expenditure would:
 - 17.1. undermine progress towards GPS priorities (e.g. reducing road safety promotion or road policing levels will have impacts on delivering the safety priority)
 - 17.2. create future spending backlogs (e.g. reducing maintenance and renewals spend will require greater future spend to keep roads safe and useable).
18. All of the activities that we have considered through this approach are outlined in Attachment 1, including (at a high level) the consequences of reducing expenditure in each area.
19. To ensure consistent ongoing levels of service, we do not recommend reducing any items identified as base expenditure, and consider there is limited value in trading these activities off against each other. We recommend the base expenditure be set aside to pay for the running of the system.

Some activities within base expenditure are facing cost pressures

20. We have singled out the activities where forecast costs of maintaining existing levels of services exceed both historical trends and the expenditure levels forecasted in GPS 2018. We consider that these are cost pressures rather than new initiatives.
21. We recommend funding is increased for these activities to maintain acceptable levels of service.
22. Table 1 provides a summary of these activities and the reasons for the recommended increases.

Table 1: Cost pressures — current estimated costs for GPS 2021 vs their estimated costs in GPS 2018

Cost pressure	GPS 2018	GPS 2021	Comment
State highway maintenance	\$7.0 billion	\$8.0 billion	<p>The NZTA's State Highway Maintenance White Paper (BRI-1737 refers) seeks to increase the funding for state highway maintenance. GPS 2018 already increased funding for state highway maintenance, which was largely a catch-up from previously constrained investment. The GPS 2018 increase was sufficient to increase road resurfacing to the recommended average of 9 percent of the network per year.</p> <p>There is still insufficient funding for pavement rehabilitation — the recommended rate is 2 percent of the network per year, but current funding is only sufficient to achieve 0.5 percent. The \$1 billion increases helps move towards the 2 percent.</p> <p>The NZTA also recommended around \$0.5 billion for GPS 2021 to address deficiencies in current levels of service, including improving state highway skid resistance, and changing practices to improve worker safety. These are potentially beneficial initiatives, but should be considered against other initiatives that improve levels of service rather than be included in the base (this is included in the cover briefing OC191098).</p>
Emergency works	\$1.3 billion	\$1.6 billion	The increased costs are primarily responding to the increased occurrence and severity of weather events. The revised number is more realistic and consistent with recent spend on emergency works.
Public transport services	\$4.2 billion	\$4.7 billion	Maintaining current outputs for public transport does not respond to natural growth that is occurring. We recommend increasing funding to help manage over-crowding, and ensure that service quality is not reduced.
Road policing	■ ■	■ ■	The GPS 2021 estimate is the cost to retain 1,070 dedicated police and 20 percent of general duties time, which includes the expected ongoing collective agreement costs (an average of 2.5 percent additional cost per year) and additional replacement of road policing equipment (such as speed radars). These are above the estimates made in GPS 2018. Any decrease from this level would need funding from other parts of the Police budget to retain the existing road policing levels.
Transitional rail	\$0.4 billion	\$0.8 billion	<p>Updated cost estimates for three Auckland metro rail projects are \$400 million higher than the GPS 2018 estimates. We will provide further advice on these costs and potential options in the week commencing 11 November 2019. We have treated these projects as part of the base, because if you take an option that will fund the projects through GPS 2021, they will be approved and committed before 30 June 2021.</p> <p>Taking a non-NLTF option to fund the projects will free up a further \$370 million from the base expenditure.</p>

23. We consider that these cost pressures are as important as base expenditure. Not responding to the cost pressures would have the same implications in terms of levels of service reductions as outlined in paragraphs 18–21.
24. In addition to the cost pressures, the NZTA has sought to build in a contingency of approximately 20 percent against all committed projects to account for possible cost increases and cost uncertainty. The total of this is \$618 million over 10 years. This contingency is not attributed to specific projects, and is an estimate based on previous experience of potential cost over-runs. We have not included it as part of the base, but instead will build it into the upper limits of the improvement activity classes. Within each activity class the funding range will be sufficiently wide to allow for potential cost changes. If these cost increases occur it will reduce the available spend across uncommitted projects and spend.

You have asked for further information on what the base will achieve

25. Maintaining the base expenditure at the recommended level will ensure that New Zealanders continue to experience the existing levels of service across the transport network. Feedback from many regions, when we undertook regional workshops across the country in March–April 2019, was that maintaining existing networks is the first priority so it is important that we get the base expenditure right.
26. Some base expenditure will also contribute to Government priorities. For example, road maintenance contributes to safety and resilience outcomes. We intend to draft GPS 2021 to ensure base expenditure contributes to delivering the strategic priorities and that the NZTA maximises the value delivered across investment.
27. We have worked with the NZTA to develop regional summaries to outline what each region will receive as part of this expenditure (OC191056 refers). In particular, this advice highlights what regions are already experiencing, and therefore what the base expenditure seeks to maintain.

Attachment 1: Items included in base expenditure

As noted in paragraphs 8-9, the actual expenditure delivered under GPS 2021 cannot be determined until the NZTA develops the NLTP. The activities below are the best estimates of the first activities to be funded, if they are within scope of the GPS, and there is sufficient funding available. All costs are estimates as at 31 October 2019, and have been built into the modelling used for GPS 2021.

	Activity	What it will deliver	Cost in base 2021/22-2030/31 (\$m)	Impact of reducing
State highways	State highway maintenance, operation and renewals	Maintain the state highway network to the levels of service aligned to the One Network Road Classification (ONRC).	8,063	Reductions might not result in immediate reductions in levels of service but would reduce network levels of service over time, which would require catch-up investment to manage.
	State highway commitments and imperatives	Cost of current improvement commitments (e.g. completing Manawatu Gorge) and essential works (e.g. bridge replacements).	2,976	Would require breaking or renegotiating contracts, would not provide sufficient funding to complete projects as approved and would restrict ability to fund end-of-life replacements.
	State highway emergency works	Allowance to repair state highway network following natural and other events.	921	These costs are non-discretionary, so without an appropriate allowance they would be met through reducing other state highway maintenance spend.
	State highway safety commitments	Cost of completing safety activities that will likely be committed by 30 June 2021.	786	Would stop construction works that are underway or approved, and could impact delivery of Road to Zero.
Local roads	Local road maintenance, operation and renewals	Pay for the NLTF share to maintain local roads to the levels of service aligned with the ONRC and council asset management plans.	7,043	This continues previous levels of investment, and any decrease might require re-negotiation for some councils with multi-year contracts for road maintenance.
	Local road emergency works	Allowance to repair local road network following natural and other events.	657	These costs are non-discretionary, so without an appropriate allowance they would be met through reducing other local road maintenance spend.
	Local road improvement commitments	Cost of co-funding to complete local road improvement activities that will likely be approved by 30 June 2021.	117	Would require reducing payments to local government for projects that have already been approved for co-funding.
Public transport	Public transport services	Cost of maintaining current levels of services for public transport	4,632	Any decrease would need to be met by reducing public transport levels of service or increases in fares/council contributions.
	Public transport improvement commitments	Approvals, or projects expected to be approved prior to 30 June 2021 – mostly infrastructure projects.	38	Would require breaking or renegotiating contracts, and would not provide sufficient funding to complete projects as approved.
	Transitional rail commitments	Projects that are approved, or expected to be approved prior to 30 June 2021 (includes cost increases for the Auckland projects).	751	Would require renegotiating or breaking contracts, and could delay the delivery and Government commitment to ATAP. Note: the total cost could change pending future ministerial decisions.

	Activity	What it will deliver	Cost in base 2021/22-2030/31 (\$m)	Impact of reducing
	Rapid transit improvements	Approvals, or projects expected to be approved prior to 30 June 2021.	48	Would stop pre-implementation and procurement works underway in Wellington and Auckland.
	Public transport improvement commitments	Approvals, or projects expected to be approved prior to 30 June 2021 – mostly infrastructure projects.	38	Would require breaking or renegotiating contracts, and would not provide sufficient funding to complete projects as approved.
	SuperGold	Cost of contingency funding for the scheme.	3	We will soon provide further advice on wider pressures arising from patronage growth, which will need to be met through the NLTF or Crown funding. This could increase the scale of this figure.
Safety	Road policing	Maintaining existing dedicated road police numbers, and funding change initiatives.	█	TBC — any funding not provided would need to be made up from other Vote Police funding.
	Road safety promotion	Maintaining existing safety programmes, including advertising campaigns, local safety programmes, and alcohol interlock subsidy.	570	Programme would need to be scaled back from currently planned — likely through reducing the scale of advertising campaigns. This could impact delivery of Road to Zero.
Other	Debt commitments	Cost of repaying debt (e.g. PPPs and Housing Infrastructure Fund).	2,757	Legal implications – would require either defaulting on or restructuring debt repayment commitments.
	Investment in the funding and allocation system	NZTA management costs not attributed directly to activities. e.g. managing the NLTP, allocation of funding to projects at a system level.	574	Would require NZTA to find ways to reduce its costs. This is an area that the Ministry intends to work on developing a stronger understanding as part of its monitoring role in the coming year, but we have not yet identified specific areas for savings.
	Walking and cycling improvements	Projects that are approved, or expected to be approved prior to 30 June 2021. Includes large ATAP and LGWM projects.	308	Would require breaking or renegotiating contracts, and would not provide sufficient funding to complete projects as approved.
	Transport planning	Funding assistance to local government to plan (e.g. business case processes).	232	Either reduced assistance to local government, or funding the costs through other areas.
	Demand management	Funding the demand management programme, including mode shift strategy.	50	TBC — programme would need to be scaled back from currently planned
	Research programme	Cost of delivering existing research programme.	47	Reduction in sector research.
Total base expenditure			35,113	