Ministry of Transport
TE MANATŪ WAKA

THE TREASURY
Kaitohutohu Kaupapa Rawa

Advice on funding Let's Get Wellington Moving

Reason for this briefing	This briefing responds to your request for advice on the suggested funding and finance programme for Let's Get Wellington Moving (LGWM) and analysis of the strengths and weaknesses of using a Special Purpose Vehicle for LGWM.
Action required	Discuss the contents of this briefing with officials.
Deadline	4 December 2018.
Reason for deadline	You are meeting with officials at 7.30am on 4 December 2018.

Contact for telephone discussion (if required)

Name	Position	Telephone	First contact
Marian Willberg	Manager, Demand Management and Revenue (Ministry of Transport)	[redacted]	✓
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MINISTER'S COMMENTS:

Date:	30 November 2018	**Briefing number:**	OC181015 T2018/3506
Attention:	Hon Grant Robertson (Minister of Finance) Hon Phil Twyford (Minister of Transport)	**Security level:**	In-confidence

Minister of Transport's office actions

☐ *Noted* ☐ *Seen* ☐ *Approved*

☐ *Needs change* ☐ *Referred to*

☐ *Withdrawn* ☐ *Not seen by Minister* ☐ *Overtaken by events*

This briefing reports back on the work you requested in October

1. On 24 October 2018 we provided you with a briefing [OC180918] outlining the work programme that the Ministry of Transport (the Ministry) and Treasury would undertake to respond to your request for advice on funding Let's Get Wellington Moving (LGWM).

2. In the previous briefing, we also mentioned that officials from the New Zealand Transport Agency (NZTA), Wellington City Council (WCC) and Greater Wellington Regional Council (GWRC) (the LGWM working group) were exploring options to split the investment package into two phases.

3. The work programme focuses on the following three key areas:

   3.1. *Workstream 1:* determine the funding share between central and local government for the first phase, including the ability of the National Land Transport Fund (NLTF) to fund the central government share

   3.2. *Workstream 2:* assess viable revenue options to fund the local share

   3.3. *Workstream 3:* assess the strengths and weaknesses of using a Special Purpose Vehicle (SPV) to deliver the LGWM package.

4. This briefing reports back on our findings from each workstream.

Executive summary

5. You asked the Ministry and Treasury to develop advice on the funding of the LGWM project and report back to you on how it might be progressed. We have worked with the LGWM working group on funding and revenue options, as well as options for packaging and phasing the initiatives. This includes looking at financing options over long periods of up to fifty years.

6. The LGWM investment package is an ambitious programme that would reshape Wellington City. It is one of several priority transport initiatives underway that would commit funding allocations in the Government Policy Statement on Land Transport (GPS) 2021 and future GPSs. While this briefing focuses on LGWM, the Ministry is developing more comprehensive advice on the impact across a fuller range of initiatives that will need to be factored into GPS 2021.

7. The current estimated cost of the LGWM package is $4.8 billion (uninflated), and WCC and GWRC (the Councils) expect the majority of this (about 70 percent) to be funded from the NLTF. We have looked at this in light of your other priorities for the current and next GPS. These include significant investments in both light and heavy rail. NZTA modelling indicates that the NLTF is unlikely to be able meet the costs of these projects under the current PayGo framework, or the cumulative costs that would arise from financing both Auckland Light Rail (if this is financed) and LGWM.

8. The Councils face a similar challenge in their own expectations of NLTF support. LGWM is a targeted package relative to the Auckland Transport Alignment Package (ATAP) (it does not take a comprehensive view of the region's transport needs), and we expect the region to continue to expect additional NLTF investment over the next couple of decades. For example, the Councils are expected to seek other transport investments such as in commuter rail ([redacted]) and road improvements. Room will need to be left for other priorities within Wellington's anticipated population share.

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9. There is scope to reconsider the scale of LGWM without significantly impacting the transport benefits. The Ministry expects the majority of benefits arise from the projects listed below in Table 1.

Table 1: LGWM projects likely to have primarily transport benefits

Component	**Cost ($m)**
A walkable city	84
Connected cycleways	36
Public transport (city and north)	324
Smarter transport network	36
Smarter pricing[1]	36
Unblocking the Basin Reserve	156
Second Mount Victoria tunnel and 4 lanes at Ruihine Street	576
Total	**1,248**

10. Many of these could potentially be funded through the existing PayGo[2] approach, subject to other competing national investment priorities and approval by the NZTA Board.

11. We understand that the undergrounding at Te Aro is a priority for the Councils. However, the Ministry is of the view that this initiative would not generate sufficient transport benefits to justify NLTF investment at the standard funding assistance rate (FAR). While this project could be moved to a second phase, the Councils are firmly of the view that LGWM should be viewed as a package.

12. The proposed rapid transit is expected to contribute to increased intensification in Wellington, but with transport benefits that are secondary.

13. The NLTF is hypothecated for the delivery of transport outcomes. The Ministry's advice is that if the rapid transit and/or undergrounding at Te Aro were to be approved by the NZTA Board and receive NLTF funding, the funding would likely only contribute to part of the investment costs that could be supported by the extent of the transport benefits delivered.

14. The LGWM working group has indicated that WCC and GWRC politicians are not fully aware of the pressure on the NLTF, and the implications this has on Wellington receiving NLTF funding. As a result, officials from WCC and GWRC have indicated that they have faced significant push back from local politicians when they have suggested scaling back or phasing the LGWM package.

[1] This project provides the infrastructure to enable Wellington to implement a cordon charge to manage demand and raise revenue.

[2] Under PayGo, the delivery of the NLTP relies on revenues generated during the same period.

15. We recommend that the Minister of Transport discuss with local politicians his priorities and theirs before proceeding further. We understand that local politicians' preference may to be to reshape the package based on an indicative funding envelope.

16. The Ministry and Treasury have worked with the LGWM working group to consider options for the Councils to raise revenue, and to finance the project. We will not be able to fully determine whether the Councils can fund their share of LGWM until we have determined the scope of the project. However, from the modelling work we have seen to date, they are likely to face challenges in funding their share of the full package at the current value, even when considering new funding tools.

17. We expect an expanded set of revenue and financing options to be key to this project. A SPV could be set up to deliver part of LGWM by raising finance to pay for the project and charging an infrastructure levy on the beneficiaries to pay back the finance raised. However, the viability of the SPV model will not be able to be tested until agreement has been reached on Worksteams 1 and 2, which will identify the funding streams.

18. It is important to note that the ability for a SPV to borrow is constrained by funding streams available to repay the debt.

The proposed package for LGWM is ambitious

19. The proposed package for LGWM is a combination of the four scenarios that went out for public consultation in November 2017 plus some additional projects. The package is more expensive than any of the scenarios that were released for consultation, and includes two particularly large scale projects:

- rapid transit from the railway station to Newtown, and then extended to the airport
- undergrounding of State Highway 1 at Karo drive to create a green space above (undergrounding at Te Aro).

20. The estimated cost of the package is $4.8 billion (uninflated) at the upper estimate. Depending on the sequencing of the investments, the cost will increase to an amount in the order of $6.5 to $6.7 billion due to inflation[3].

The NLTF is already heavily committed fund to the Government's priorities

21. The Government has signalled a number of large scale infrastructure projects that it intends to progress. These include Auckland light rail, LGWM, rapid rail, and funding heavy rail through the NLTF.

22. Based on expected levels of revenue and expenditure, there is unlikely to be sufficient NLTF revenue to progress all of the above initiatives on a PayGo basis. Some form of debt-financing will be required to progress your transport priorities, including the NLTF share of LGWM.

But there are future implications arising from debt-funding large scale infrastructure projects

23. Debt servicing costs are funded from future NLTF cash inflows that would otherwise be available to fund other expenditure.

[3] The inflation assumption used in the current modelling is based on the Transport inflation prices provided by BERL. On average the inflation rate is 2.3% per annum.

24. In addition, the commitment to repay the debt constrains future policy and reprioritisation decisions, while also limiting the NLTF's ability to respond to future shocks such as natural disasters or reduced economic growth.

25. As debt will always add cost to a project, the use of debt should improve the overall efficiency of NLTF spending. For example, where the use of debt will enable high value projects to proceed, which are then 'paid for' by reducing expenditure in out-years on lower value projects.

Reprioritisation within the NLTF will be required if you wish to progress the entire LGWM proposal

26. NZTA modelling indicates that the NLTF is unlikely to be able to meet the cumulative costs of funding both Auckland light rail and LGWM even with long-term financing for both programmes. Given that it will not be possible to fund all of your priorities within the NLTF, you will need to either reprioritise or consider other revenue sources, such as Crown funding.

The Wellington region will require other transport investments outside of LGWM

27. The LGWM package is only one component of the transport investments that may be required in the Wellington region over the next two decades. We are aware that there are a number of other transport investments that are not included in the LGWM package that the Wellington Region is interested in progressing, including commuter rail improvements ([redacted] pressure over the next decade to meet forecast growth) and road improvements, as well as infrastructure and services signalled in its Regional Land Transport Plan (RLTP). Other investment priorities will also arise in the future.

28. Table 2 below shows estimated costs for the transport projects, other than LGWM, that we understand are included in the draft Wellington Regional Investment Plan (WRIP). This shows the potential size of the WRIP transport package and commitment required from the NLTF, local government or private sources to support the package. It is our understanding that of the projects in the table, only the rail track upgrades have fully committed funding through the NLTF. The WRIP will also seek additional investment for regional economic development, housing, resilience and environmental initiatives.

Table 2: WRIP projects

WRIP Project	**Estimated Cost ($m)**
Rail Track Upgrades	193
Ngauranga-Petone Cycleway	85
Petone to Granada Link Road	260
Cross Valley Link Road to Seaview	100
Riverlink/Melling State Highway and Rail Improvements	57
Ferry Terminal	[redacted]
Airport Runway Extension	330
Total	[redacted]

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29. LGWM and the Auckland Transport Alignment Project (ATAP) are fundamentally different in this sense. The ATAP Package sets out all transport investment priorities for the 2018 – 2028 decade that reflect the Government's and Auckland Council's shared direction for transport across the Auckland region.

30. It is important for the Councils to fully consider their transport priorities for the medium- to long-term. There is a risk that funding the central government share of the entire LGWM package from the NLTF will put the Councils in a position where they have to significantly delay, or not progress other valuable transport investments in the future.

There is an option to split the package into two phases

31. The LGWM working group has been considering options to split the package into two ten-year phases. The intention of this approach is for the first phase of the package to be fully funded, and for further work to be done to determine funding for the second phase.

32. This approach came about in response to the Minister of Transport and local politicians' desire to publicly announce a LGWM package in early 2019. LGWM has been in the public sphere for some time and the public has been expecting an announcement on the recommended programme of investment this year. The LGWM working group has emphasised that it is important for the credibility of the project that an announcement is not delayed for too long.

NLTF funding should be prioritised for projects where the benefits are primarily transport-related

33. Projects where the benefits are primarily transport related should take precedence for NLTF funding. Moving away from this approach has the potential to undermine the effectiveness of the NLTF in building and maintaining a network that delivers good transport outcomes, and to break down the distinction between the hypothecated transport fund and the government's consolidated fund.

34. While we have not yet seen a breakdown of the benefits of individual projects, the Ministry is aware that undergrounding at Te Aro and rapid transit projects are unlikely to generate substantial transport benefits relative to the cost of the projects.

35. We have considered whether you could approach funding projects with co-benefits such as urban development benefits in a different way to current funding arrangements. Some principles for this are outlined under Workstream 1.

36. The Ministry's advice is that the projects with primarily transport benefits should be included in the first phase of the project. These projects are listed below in Table 3. The cost of these is estimated to be around $1.2 billion.

37. To what extent these projects can be funded from the NLTF is subject to:

    37.1. the availability of funding – especially within the relevant activity classes and notably in state highway improvements, for which scope for adding additional projects beyond those already programmed is already very limited

    37.2. other competing national investment priorities

    37.3. approval by the NZTA Board.

38. Should you wish to progress these projects, we will continue to work with the NZTA to fully determine whether they are fundable.

Table 3: LGWM projects likely to have primarily transport benefits

Component	**Cost ($m)**
A walkable city	84
Connected cycleways	36
Public transport (city and north)	324
Smarter transport network	36
Smarter pricing[4]	36
Unblocking the Basin Reserve	156
Second Mount Victoria tunnel and 4 lanes at Ruihine Street	576
Total	**1,248**

39. The second Terrace tunnel, and a fourth southbound lane between Ngauranga and Aotea do deliver transport benefits, but the LGWM working group has advised that these projects are intended to be a longer-term priority. Therefore, we don't recommend they be included as part of the first phase.

40. It is important to note that the inclusion of any LGWM projects in the National Land Transport Plan will be subject to approval by the NZTA Board based on assessment against the Investment Assessment Framework according to their value for money and alignment with the priorities, objectives and expected results within the GPS.

You could consider developing detailed businesses cases to accelerate the rapid transit and/or undergrounding of Te Aro projects

41. If you wish to accelerate the rapid transit and/or undergrounding in Te Aro projects, we recommend that you commission a detailed business case for each project to consider the full range of options to deliver each project, assess the costs and benefits, and examine the range of funding and financing options available. This could include an analysis of the options to contribute additional Crown funding to accelerate the project.

42. Politicians from WCC and GWRC are concerned that having two separate ten-year phases could mean that the second phase does not progress. However, taking a phased approach signals an indicative commitment to these projects also provides the opportunity for both the Government and Councils to to look at a broader range of funding options, and funders.

The phasing options considered by the LGWM working group are unlikely to be affordable within the NLTF

43. The LGWM working group has developed three options for how the package can be delivered over two ten-year phases. These options are centred on the approach of separating some of the larger, more complex projects into the second phase, and

[4] This project provides the infrastructure to enable Wellington to implement a cordon charge to manage demand and raise revenue.

progressing with the smaller-scale projects that could be funded on a PayGo basis in the first phase. The three options are listed below in Table 4. The cost of the first phase (shown in green) is likely to be between $2.4 billion to $3.1 billion (uninflated) depending on the preferred option.

Table 4: Phasing options

Programme element	**Capex $m**	**Option**		
		1	**2**	**3**
A walkable city	84			
Connected cycleways	36			
Public transport (City and North)	324			
Smarter transport network	36			
Smarter pricing	36			
Unblocking the Basin Reserve	156			
Rapid transit Railway Station – Newtown	1,188			
Rapid transit Newtown to – Airport	540			
Second Mount Victoria tunnel and 4 lanes at Ruihine Street	576			
Undergrounding at Te Aro	1320			
Second Terrace tunnel, and a fourth southbound lane between Ngauranga and Aotea.	480			
Phase 1 cost		2,436	2,400	3,180
Phase 2 cost		2,340	2,376	1,596

44. Based on NZTA modelling, there is insufficient NLTF revenue to deliver the first phase of LGWM under any of the options above unless fuel excise duty and road user charges rates were to increase in line with inflation each year. Even then, the delivery of the first phase of LGWM and light rail would come at the expense of other transport priorities (such as heavy or Auckland light rail).

The LGWM Alliance Board has pushed back on splitting the package into phases

45. We have been advised by the LGWM working group that the Governance Group (Mayor Justin Lester, the GWRC Chair and officials from WCC, GWRC and NZTA) has not had a chance to consider a phased approach. However, the Alliance Board (Chief Executives from the Councils and officials from NZTA) is apprehensive about this approach as it is concerned that the second phase will not go ahead. We expect the Governance Group will share a similar view. As mentioned previously, we have had an indication that the Councils will not

be willing to contribute to funding rapid transit if the whole LGWM package does not progress.

46. Due to the push-back from the Alliance Board, and the indication that the Governance Group will share a similar view, we have not been able to determine the preference of the Councils for splitting the project into two ten-year phases.

47. The LGWM working group has indicated that its decision makers are likely to prefer an approach where central government signals an indicative funding envelope for LGWM. Its intention is that the LGWM proposal will then be reshaped to fit within this envelope. This is because the LGWM investment programme has been designed on the basis that it will be put forward as a package. There are many interdependencies within projects, and removing certain projects could impact the expected benefits of other projects.

The Minister of Transport should discuss with local politicians his preferred approach and theirs, for progressing LGWM

48. The Minister of Transport is meeting with the Governance Group on Tuesday 4 December to discuss next steps for LGWM.

49. The advice we have put forward in this briefing is unlikely to be the answer they are expecting. The LGWM working group has indicated that WCC and GWRC politicians are not fully aware of the pressures on the NLTF, and the implications this has on Wellington receiving NLTF funding. As a result, officials from WCC and GWRC have indicated that they have faced significant push back from local politicians when they have suggested scaling back or phasing the LGWM package.

50. We suggest that you work with local politicians to manage their expectations, and ensure that you understand each others respective priorities. This will enable the Councils to work with NZTA, the Ministry and Treasury to develop a LGWM package that you can announce as fully funded.

51. As mentioned above, politicians from WCC and GWRC may have a preference to reshape the package to fit within an indicative funding envelope. This will take some time, and could mean that you will not be in a position to make an announcement on LGWM in early 2019. We recommend that you discuss this with local politicians to determine their position.

<u>Workstream 1: Determining the funding split</u>

There may be a case to deviate from current funding arrangements to share the cost of projects with co-benefits

52. If the package was funded under current funding arrangements, including using current FARs, the central government share, which would be funded from the NLTF could be around 94 percent. This is because most of the costs relate to either state highway or rapid transit projects as set out in Table 5 below. State Highway projects receive 100 percent FAR, but there is still some uncertainty around the arrangements for rapid transit projects. The current assumption is 100% FAR based on the approach for Auckland.

53. The GPS states that the significant cost of rapid transit infrastructure means that alternative funding arrangements will be required to deliver rapid transit and supplement the funding available in the NLTF. Shared funding and financing arrangements involving local government and third parties may also be needed. For the purposes of this briefing we have assumed that rapid transit will receive 100 percent FAR.

Table 5: Cost sharing implied by existing FAR rates[5]

Activity Class	Assumed FAR	Total cost ($m) (uninflated)	Implied NLTF Share ($m)	% of total cost
Public transport	51%	360	184	51
Rapid Transit	100%	1,728	1,728	100
Walking and cycling improvements	51%	120	61	51
Local road improvements	51%	36	18	51
State highway improvements	100%	2,532	2,532	100
Road safety and demand management	51%	36	18	51
Totals		**4,812**	**4,542**	***94***

54. The LGWM working group determined that some of the large projects, such as undergrounding at Te Aro, with limited transport benefits, would be unlikely to be approved by the NZTA Board for NLTF funding.

55. Because the Councils are committed to delivering the entire package, the LGWM working group developed an alternative funding arrangement on the basis that the Councils could contribute a greater amount to fund projects that provide limited transport benefits, but significant urban amenity benefits. Based on the assumption of committing to the entire package, the original proposal was that central government would fund two thirds of the entire package through the NLTF, and the Councils would fund one third.

56. This is a significant departure from established funding arrangements and our view is that such a departure should be based on a more principled approach. The funding split for the package should be determined on an individual project basis, and that the split should be based on the type, and level of benefits generated by the project.

57. There may be a reason to deviate from current funding arrangements for projects that generate significant co-benefits. For projects like this, a bespoke approach to splitting the funding between central and local government (i.e. an alternative FAR) could be taken. However, analysis would need to be undertaken to determine where project benefits fall, and who should pay in order to be confident that the basis for deviating from the status quo is robust.

58. The Ministry and Treasury have engaged with the LGWM working group on this matter. We have agreed that traditional projects, where the benefits are mostly transport related, should be funded according to current arrangements, and that there may be a case to treat large projects with significant urban amenity benefits differently. The two projects proposed to be treated differently are undergrounding at Te Aro and rapid transit. Should you wish to progress these projects, we can work with the project partners to determine an appropriate funding split.

59. The LGWM Alliance Board is comfortable with this approach. The LGWM working group has not had a chance to take this approach to its Governance Group, but has indicated that it is likely to be comfortable with it.

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[5] The costs in this table are estimates at the 95th percentile

60. The willingness of the Councils to contribute funding to rapid transit is likely to be contingent on the whole package progressing, especially undergrounding at Te Aro.

NLTF revenue is allocated based on an assessment of value for money and alignment with the GPS

61. For financial modelling purposes, to find a way in which the entire package could be funded, the LGWM working group has been using the assumption that Wellington will get its current population share of the NLTF, which is around 11 percent. We have concerns with assuming that the NLTF will be allocated to regions based on population size related to funding principles and affordability. Additionally, we have concerns about the precedent this could set for other regions.

62. There is currently no prescriptive mechanism for allocating the NLTF regionally. How – and, by extension, where – the NLTF is invested is determined by using tools and processes to establish the strategic and economic cases for, and the viability of, investments. Projects and programmes are also tested on a national basis for alignment with strategic priorities in the GPS. Investments are prioritised in the NLTP on the basis of these considerations.

63. This approach can be considered to be priorities-led – as the land transport system is statutorily designed to see priorities signalled in the GPS reflected in the mix of projects in the NLTP.

64. While over the long-term it may be reasonable to expect investment to roughly match demand on regions' transport networks, investment may be more unevenly distributed in the short- to medium-term due to factors such as:

    64.1. the lumpiness of many significant transport infrastructure investments

    64.2. the benefits of coordinating programmes of investment/co-delivering transport infrastructure with other developments (such as utilities infrastructure, to service new housing developments)

    64.3. labour availability

    64.4. the relative levels of urgency attached to certain investments.

65. Maintaining a level of flexibility in the way investment is carried out therefore allows room for the complexities of transport investment, and enables an adaptable approach to be taken.

66. We also note that there is no perfect proxy for the level of demand on a region's transport network. None of the possibilities (such as population share or density, vehicle kilometres travelled, network size) necessarily:

    66.1. reflect that there are differences between the types of transport needs that different regions have (e.g. some regions have much larger urban areas than others)

    66.2. capture the different levels of funding that would be required to satisfy these.

67. We will provide more advice on this issue in respect of light rail investment in Auckland in a future briefing.

<u>**Workstream 2: Funding the local share**</u>

68. Due to the significant amount of capital required to deliver the package, and the desire to deliver the package within the next 20 years, the Councils are not able to use a PayGo

approach and would need to take on additional debt supported by additional revenue streams to fund their share.

69. The Councils are currently working on potential revenue streams they could use to service debt. We will not be able to fully determine whether the Councils can fund their share of LGWM until we have determined the scope of the project. However, from the modelling work we have seen to date, the Councils are likely to face challenges in funding their share of the package at the current value. We will continue to work with the Councils to understand their ability to generate revenue to service debt and the associated economic and social implications.

[redacted] [redacted]

[redacted] [redacted] Withheld to protect future negotiations

72. While the Councils can borrow more without exceeding their debt limits, the extent to which they can borrow is constrained by their ability to generate revenue to service the debt.

73. This will also mean an increase in interest costs, depreciation charges and operational expenses which all need to be covered by an increase in rates (or other income) in order to meet the balanced budget test. We haven't calculated the increase in revenue this would need, but this initial assessment does show what is possible from a financing perspective. In some cases infrastructure costs could be recovered through development charges which may limit the impact. A further consideration is the impact on a council's external credit rating.

Workstream 3: Assessing the potential to use a SPV for LGWM

74. The alternative financing models, which are being developed by Treasury as part of the Infrastructure Funding and Financing (IFF) programme could be utilised for LGWM. In essence, the proposal is that a SPV is set up to deliver a new project. It raises finance to contribute to the cost of the project and charges an infrastructure levy on the beneficiaries to pay back the finance raised.

75. These models are primarily designed as a financing mechanism – to better leverage funding sources and to keep the debt raised from impacting the debt/revenue ratio of Councils. Without clear funding streams, we are unable to assess how a SPV could be utilised for this programme of work at this stage.

76. On that basis, we are recommending that this workstream is only commenced once agreement has been made on Workstreams 1 and 2 (which will identify the funding streams and enable us to test against the financial model of the SPV structure).

77. It is important to note that the ability for a SPV to borrow is constrained by funding streams available to repay the debt, and there is a limit to how much additional revenue can be levied on developers and/or incumbent rate payers.

We will provide you with further advice on addressing funding challenges within the land transport investment system

78. LGWM is not the only challenge the land transport investment system faces. You have signalled a number of priority transport investments that will require NLTF funding.

79. We will provide you with further advice shortly on the fit between your current transport priorities and forecast NLTF revenue. The immediate focus will be on LGWM and the Auckland City Centre to Mangere Light Rail project, but we note that decisions on these projects will also have implications for future GPS commitments. Work on the next GPS is underway, with a draft scheduled for release at the end of 2019.

Recommendations

80. The recommendations are that you:

(a) **discuss** the content of this briefing with officials at your meeting on 4 December 2018 — Yes/No

David Taylor
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Hon Grant Robertson
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