Coversheet: Infrastructure Funding and Financing Regulatory Impact Assessment

Advising agencies	The Department of Internal Affairs and the Treasury
Decision sought	Agreement to issue drafting instructions for new legislation and amendments to existing legislation that enable the use of alternative financing mechanisms to support the timelier provision of infrastructure.
Proposing Ministers	Minister of Housing and Urban Development, Hon Phil Twyford

Contents

List of Abbreviations

CCO – Council Controlled Organisation

CIP – Crown Infrastructure Partners

FDS – Future Development Strategy

GSP – Government Support Package

HBA – Housing and Business Assessment

HIF – Housing Infrastructure Fund

HUDA – Housing and Urban Development Authority

IFF – Infrastructure Funding and Financing work programme

IRD – Inland Revenue

LGA – Local Government Act 2002

LGFA – Local Government Funding Agency

LGRA – Local Government (Rating) Act 2002

NPS-UDC – National Policy Statement on Urban Development Capacity

NZTA – New Zealand Transport Agency

OIC – Order in Council

RIA – Regulatory Impact Assessment

SPV – Special Purpose Vehicle

The Department – The Department of Internal Affairs

The Model – The legislative charge model

UGA – Urban Growth Agenda

Summary: Problem and Proposed Approach

Problem Definition

New Zealand is facing a housing affordability challenge. One of the fundamental drivers of house prices is the supply of urban land that is serviced by infrastructure. However, local authorities face several challenges when it comes to supplying serviced urban land, in particularly financing of housing related infrastructure. This constraint is contributing to high house prices and in Auckland, house prices are now close to three times their fundamental cost, with land value accounting for 67% of the average dwelling's capital value.

To resolve the affordability challenge the government is reforming the urban planning environment through the Urban Growth Agenda (**UGA**). The main objective of the UGA is to improve housing affordability, underpinned by affordable land. It is designed to address fundamentals of land supply, development capacity and infrastructure provision by removing undue constraints. This regulatory impact assessment is focussed reforming the system for the financing of infrastructure which is one of the key challenges to housing affordability. Refer section 1 for further detail on the UGA.

Infrastructure supply is constrained by financial restrictions on local authorities, who provide most network infrastructure. In a number of our high growth regions, local authorities are facing constraints in their ability to invest in infrastructure to support and service growth. In particular, the demand for new housing is outstripping local authorities' ability and willingness to take on further debt, meaning there are infrastructure investments that can be funded over time, but not financed from local authority balance sheets.

The UGA's Infrastructure Funding and Financing work programme (IFF) looks to overcome these financing constraints. The constraints which are limiting the borrowing capacity of local authorities are:

- contractual requirements to meet Local Government Funding Agency (LGFA) borrowing covenants; and
- a focus on maintaining their credit ratings to minimise borrowing costs, and the financial prudence regulations set out in the Local Government (Financial Reporting and Prudence) Regulations 2014 (the Benchmarking Regulations)[1]

The LGFA covenants are the immediate binding constraint, with most local authorities able to borrow at least twice as much before they would breach the debt servicing ratios within the Benchmarking Regulations. Most high growth councils are close to their maximum debt levels (with debt at only 250% of revenue), this constrains their ability to borrow to deliver projects. This results in a long list of "unfunded" but economically positive projects that cannot proceed.

The challenge of providing local infrastructure is magnified by underlying issues with institutions and incentives. These include:

- Local infrastructure investments tend to be large, lumpy and irreversible, with long

[1] The Benchmarking Regulations contain 7 benchmarks for financial management by local authorities yet for the purpose of this paper, we are focussed on the debt servicing benchmark within the Benchmarking Regulations which requires borrowing costs for high-growth local authorities to be less than 15% of revenue.

lead times and the risk of stranded assets if forecast demand does not eventuate.

- A funding structure which leaves existing ratepayers carrying the risk of financing and funding, at least in part, as providing for growth often involves expenditure both at the margin and at the network level.
- The misalignment of costs and risks between ratepayers, local authorities and developers creates a strong disincentive for local authorities to invest in local infrastructure ahead of anticipated demand pressures and instead to provide local infrastructure on a just-in-time basis, limiting the supply of serviced urban land.
- A financing structure that puts minimising the cost of borrowing as the supreme financing priority and removes the ability of individual local authorities to move beyond very conservative debt limits. This can become an absolute barrier to investment, but also leads to significant competition for available financing between growth infrastructure and other investment aspirations.
- The fact that many major local infrastructure investments have multiple purposes, and are not exclusively to provide for growth, means that funding is constrained by the ability of the local authority to fund and finance the non-growth component of the investment.

Alternative financing mechanisms, not viable under current legislation, are required to overcome local authorities' financing constraints and realign development incentives including risk allocation, to ensure necessary local infrastructure can be delivered in a timely manner. This will help ensure that sufficient land is serviced to meet housing demand, increase competition in land markets (bringing down the cost of urban land) and ensure an appropriate allocation of cost and risk. These changes will help to improve housing affordability.

While the Infrastructure Funding and Financing work programme (IFF) is one pillar of the UGA, it will not resolve the housing challenges on its own. A suite of interventions are needed. The IFF will make a difference where there are financing constraints for local infrastructure provision. It will help to uncouple infrastructure decision from the existing financing constraints and instead focus on whether the projects are beneficial in order to proceed.

Illustrative example of the status quo approach to financing infrastructure

Currently, if a new housing development requires infrastructure to support it, there are a number of processes that a developer will need to work through. The scenario below focuses on how local infrastructure that supports a development in an area currently unserved is funded and financed.

Bernie, a developer, has a large plot of land in Waho and wishes to develop 2,500 new homes but the trunk infrastructure to support the development is not currently in place. The area is identified as a future urban zone, but not until 2026.

Bernie believes the development is commercially feasible and approaches the council to have the infrastructure put in place early to support the proposed 2,500 new homes. The council considers Bernie's application and agrees that the development should proceed. The council agrees to put in the infrastructure, but not until 2026 and needs to recover the $130 million cost of the infrastructure. Consistent with their financial planning documents *and development contribution[2] (DC) policy, the council requires that a DC of $52,000 per property be paid when the building consent is issued on each property. Bernie agrees and decides to sit on his land in anticipation of the infrastructure being put in place in 2026.*

In 2026 the council borrows the $130 million and puts the necessary infrastructure to support the housing development in place.

As Bernie begins to develop, he finds some unforeseen geotechnical land constraints and is only able to build 1,200 homes, instead of the 2,500 anticipated. The council, despite having built sufficient network capacity for 2,500 homes, is now only able to recover $62.4 million ($52,000 per house build) from Bernie, instead of the $130 million cost incurred to support the housing development. This leaves the council – and general ratepayers – burdened with the remaining $67.6 million of infrastructure to pay for, as well as the ongoing operating, maintenance and depreciation costs associated with the infrastructure.

Under this approach, the council – and therefore general ratepayers – have taken on the development risk. The developer capitalised the DC into the sale price of the 1,200 homes, meaning purchasers of the new homes have paid for that infrastructure upfront as part of the price of their home.

Proposed Approach

The Department and the Treasury propose a legislative charge model (**the Model**) that supports timelier provision of local infrastructure[3] underpinning housing and urban development.

The Model is an important step in the longer-term evolution of the local authority funding and financing system. Currently, local authorities rely heavily on their general obligations. This means that the interest and principal repayments of a local authority's debt are guaranteed by their full financial resources and taxing power. Expanding this toolkit to have specific revenues pledged against specific debt helps to transfer the cost and risks of a project to a more appropriate party such that growth can pay for growth.

The core of the Model involves the setting of a multi-year levy (**the Levy**) which is paid by beneficiaries of local infrastructure projects. The Levy will be enabled by legislation and can only be struck following an Order in Council which will set out terms of the Levy. The Levy will be levied by a Special Purpose Vehicle (**SPV**[4]) who is responsible for financing all

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[2] Development contributions are a charge that new developments pay the council to recover the cost of infrastructure provided to support growth.

[3] The proposed scope of infrastructure for the model means new or upgraded infrastructure that falls within the following categories:

- water, wastewater and stormwater;
- transport and associated infrastructure including both local roads and state highways;
- public transport, including rail, busways, park and ride exchanges, stations and shelters;
- community amenities to the extent they form part of a wider project; and
- environmental resilience infrastructure, such as flood protection, pump stations and environmental restoration.

[4] An SPV is a standalone entity that is created for a specific financial purpose. The SPV is shut down once that purpose is complete. In this case the SPV will be responsible for raising the finance for a Project and managing construction. It will use the Levy to raise finance to fund infrastructure.

or part of the project, and also has the power to collect the Levy. The Levy is used to service financing raised to cover the costs[5] of the infrastructure. In most cases the SPV will be responsible for construction of the infrastructure assets. Once constructed, the infrastructure will then vest with the relevant local authority or public body for nil or no consideration. A SPV may have a direct role commissioning construction of the infrastructure but does not always need to.

Approval mechanisms for the infrastructure project and Levy at the central and local government level will be important to protect the interests of beneficiaries.

The Model enables local infrastructure projects to be funded without being limited by the financial constraints faced by local authorities (especially high growth local authorities). Specifically, the Model allows a project to be ring-fenced from the individual local authority's normal finances and overcomes the financing constraint. There is no financial or moral recourse to the local authority. Making such Levies available to third parties is a significant but necessary shift to enable the Model.

To the extent possible, the Model will transparently allocate costs and risks associated with a Project to the most appropriate party, removing some of the cross-subsidisation elements and altering development incentives under the status quo approach to local infrastructure provision. An increase in supply of serviced land, and the ability for un-serviced or under-serviced land to be serviced more quickly will help increase competition in land markets, increasing land supply and bringing down the price of urban land.

The Crown's involvement and provision of statutory powers are necessary to enable the Model to work. For example, under the status quo, all decision rights for the provision of local infrastructure sit with the local authority. For the Model to work, certain decisions, rights and some tail risks will transfer to the Crown. Due to the level of control that Crown has over the SPV (design of the SPV, approval of the Levy), pursuant to the relevant accounting standard, the assets and liabilities of the SPV will consolidate onto the Crown balance sheet. This should not result in additional net liabilities as the assets and liabilities will offset. These Crown support mechanisms are described in more detail in the appended Treasury Report (paragraph 16, page 4; paragraphs 95 - 99, page 31; and sections 7 and 8).

The Model is an extension of the contractual model currently used by Crown Infrastructure Partners (CIP) and overcomes the coordination and negotiation challenges under the existing CIP model.

The Model has some features that do more than unlock the current financial constraints of local authorities. It reforms the local authority financing system so that:

- costs of growth are allocated so that they fall on the communities and homeowners who benefit from the new infrastructure;
- viability of projects becomes the key determinant on whether they proceed (this removes the trade-offs that local authorities often make when allocating resources and ensures that infrastructure is more responsive to demand);

4 SPV ownership structures could range from Crown owned through to privately owned. The only SPV ownership structure that would not work is local authority ownership by the local authority that is to receive the infrastructure (which would not meet rating agency requirements).

5 Eligible costs that may be recovered through the Levy are detailed in the appended Treasury Report.

- there is greater rigour and transparency in the allocation of risk and costs to the appropriate parties;
- price signals are provided through the use of the Model to help ensure investment occurs where the market demands it; and
- a much greater quantity of debt is able to be leveraged from revenue streams than would be possible through a local authority.

The Model will continue to work with complementary regulatory regimes, such as resource and building consenting processes. However, as the Model provides local authorities an additional tool to finance infrastructure, this may influence how local authorities allocate capital, meet other regulatory requirements (such as National Policy Statements) and plan urban development.

Illustrative example of the proposed alternative approach to financing infrastructure

Bernie, a developer, has a large plot of land in Waho and wishes to develop 2,500 new homes but the trunk infrastructure to support the development is not currently in place. The area is identified as a future urban zone, but not until 2026.

Bernie believes the development is commercially feasible and approaches the council to have the infrastructure put in place early to support 2,500 new homes being built. The council considers Bernie's application and agrees that the development should proceed but cannot afford to bring forward the local infrastructure investment as they don't have much debt capacity left. The council suggest Bernie look at funding and financing the local infrastructure via the Model if he wishes to advance the timing of the infrastructure.

Bernie decides to put together a feasibility case to take to the government's IFF facilitator. He identifies the area of benefit from the development and estimates the costs of the infrastructure. The IFF facilitator supports the business case, and works with Bernie to figure out a financing structure and an appropriate Levy.

Bernie, through the IFF facilitator, presents the business case for development to the government. If the government supports the development they make an Order in Council that enables a Levy to be set within very specific parameters on properties in the identified benefit area through a SPV. The SPV raises the necessary finance from debt or equity markets and begins building the local infrastructure.

During construction of the 2,500 homes, Bernie finds some geotechnical challenges that reduce the area of developable land. Because the land is being charged through the SPV for the infrastructure, Bernie is incentivised to reconfigure the development across the smaller developable area. Bernie reconfigures the development, increasing the number of townhouses in the development. He also re-purposes the constrained land as green open space for the residents to enjoy. Once complete, the local infrastructure is owned and operated by the council.

Because Bernie hasn't had to pay a DC, he hasn't passed that cost onto the home buyers in the price of the new homes. However, purchasers of the new homes see that they have an IFF Levy to pay every year, and factor this cost into what they offer Bernie for the *homes.*

Under this approach, Bernie rather than the council (and existing ratepayers) carried the development risk and has brought on housing development faster than anticipated. Bernie still built 2,500 homes and provided more green space than originally anticipated. The home buyers covered the cost of the infrastructure to service the area they now live in. However, they didn't need to cover the cost of the local infrastructure upfront, and instead will pay for it over time, reducing the initial purchase price of their homes.

Section B: Summary Impacts: Benefits and costs

Who are the main expected beneficiaries and what is the nature of the expected benefit?

Monetised and non-monetised benefits

The UGA aims to improve housing affordability, underpinned by affordable land. The IFF work programme – as part of the UGA – is designed to support the responsive provision of local infrastructure to service land for housing by overcoming local authorities' financing constraints to delivering local infrastructure and providing for appropriate cost and risk allocation. Overcoming these constraints will support timelier provision of housing and support competitive urban land markets.

The Model represents a new way of funding and financing local infrastructure in New Zealand. Importantly it provides a financing tool that that is independent of local authorities.

Generally, mitigating housing supply constraints such that homes are more affordable represents potentially significant economic gains for New Zealand by alleviating economic distortions created by an inefficient housing market. High house prices can result in a misallocation of labour away from high-productivity regions, such as Auckland. A recent study suggests that "*comprehensively removing constraints to housing supply would have increased New Zealand's total economic output by up to 7.7%, increased per-worker output by 0.9%, and eliminated recent net migration outflows to Australia. More plausible counterfactual scenarios would result in smaller, but still economically meaningful, gains in the order of one to five percent of gross domestic product.*" (Nunns, 2019).

There are a range of direct beneficiaries of the Model. However, the exact nature of the benefits that beneficiaries realise will be highly context specific. Broadly, these beneficiaries and benefits are:

> **Local authorities** will have a new tool that assists them to be more responsive to local infrastructure demand, and support more urban development than possible under the status quo. It will shift some development risk from local authorities – and therefore general ratepayers – to landowners. Where Projects are delivered under the Model, the local authority will not have had to fund or finance the local infrastructure upfront. This will leave them responsible only for the ongoing operating and maintenance costs associated with the asset(s) on completion of the infrastructure.
>
> To the extent that this frees up debt capacity for local authorities, it will enable local authorities to make different choices about how they allocate their scarce capital

(for example to support community wellbeing, or transport investments).

Project community is the collection of identified direct project beneficiaries. Typically, a project community will be landowners whose land has access to, or use of, local infrastructure services flowing from the project. Generally, the project community will be land or homeowners within a project catchment area. Some projects may have wider network or indirect benefits.

Identified beneficiaries are the home buyers / home owners / existing properties within a project community will benefit from the local infrastructure provided via the Model. These consumers, while paying a Levy, will benefit from access to the infrastructure and the upfront costs of the local infrastructure not being capitalised into the purchase price of their home.

Existing residents and landowners within the project community will receive benefit flowing from a project, such as value uplift in their land, improved levels of local infrastructure services, and/or additional development capacity on their land, but will likely be subject to a Levy.

General ratepayers/residents of the local authority (as distinct from the Project community) will have increased housing choice – typology, location and price.

Financiers will receive a return from their investing activities.

The Crown. The Model also overcomes the need for more direct Crown interventions, such as the Housing Infrastructure Fund, or direct provision of local infrastructure, or other direct financial support.

Broadly, we know from the Crown Infrastructure Partners (**CIP**) experience that the benefits are well understood by local authorities, financiers and the Crown. However, as houses being enabled through the CIP encumbrance model have yet to be sold to the general public, we are unsure how home buyers will receive the CIP model or the proposed legislative charge Model. The select committee processes should enable these views to be better understood.

Where do the costs fall?

Monetised and non-monetised costs; for example, to local government, to regulated parties

The distribution of costs associated with a project being funded and financed under the Model will vary from project to project. This is because the infrastructure funded and financed by the Model and identification of beneficiaries will be project and context specific. For example, a brownfield project may have a wider project community than a more discreet greenfield project and have different infrastructure requirements. For some investments, it is conceivable that the full costs will be recovered from the beneficiaries, for others the council may make a financial contribution from general rates where there is reason to do so. The Model is designed to follow a 'beneficiary pays' principle and improve transparency, recover of the costs and appropriately allocate the risks associated with growth related infrastructure provision.

The Levy, which covers the costs of a project authorised by the Order in Council will be imposed on the beneficiaries of a project. Some costs may also be borne by local authorities where they contribute to a project or expend resource in considering a Project. Similarly, the New Zealand Transport Agency may bear some costs should they contribute to a transport project/component via the National Land Transport Fund. However, these costs are likely to be opportunity costs arising from a redistribution of expenditure, rather than net additional costs. Net additional costs are described below.

The Model will impose some transaction and financing costs above those under the status quo. These additional costs are unlikely to be significantly more relative to the status quo approach, or to the scale of local infrastructure investments. The incidence of these costs will be variable, depending on what costs are included when calculating the Levy. These new or marginal costs mainly relate to establishment and compliance such as:

Proposer costs including: feasibility case, funding proposal, structuring and procurement costs (some of these costs would be incurred regardless of whether the project was proceeding under the Model).

Facilitator costs including: input into, and review of, feasibility case and funding proposal, and assistance with structuring.

Monitoring and enforcement costs associated with a project could be recovered by the monitoring entity by charging a SPV to undertake its functions. Where this occurs, the costs charged by the monitoring entity will need to be stipulated in the Order in Council. In such a case, those paying the Levy will bear the cost.

Alternatively, the Crown could directly fund these costs.

SPV owner costs including: due diligence, equity arrangement fee, and letter of credit fee.

SPV management costs including: contract management, collection/enforcement, legal disputes and director fees.

SPV administration costs including: insurance, legal, accounting, tax and reporting.

Financing costs (borrowing costs) for a SPV may be slightly higher than if funded through a local authority's balance sheet as the security is a specific revenue stream. This compares with the status quo where the general revenues of a local authority are security against its debt.

Like the beneficiary set, there are a number of different parties who will directly bear a portion of these and other costs:

Local authorities may need to provide equity or other financial contributions to ensure a Project is viable. Local authorities may also be responsible for ongoing operating, maintenance and depreciations costs once an infrastructure asset vests to them at transfer.

Identified beneficiaries from the project will be required to pay a Levy for the benefit they receive. A Levy will be in addition to existing rates.

The Crown may support projects through a negotiated government support package that picks up risks that cannot be transferred to another party or priced appropriately. The Crown may also choose to fund the facilitation, monitoring and enforcement functions associated with the Model.

SPVs will have ongoing compliance and audit costs associated with the Model.

The Model provides for these costs to be included when determining the level of a Levy[6]. However, it is not envisaged that the full suite of costs will be included for every project as it will not always be feasible/affordable for every cost to be included.

What are the likely risks and unintended impacts, how significant are they and how will they be minimised or mitigated?

There are a number of risks associated with the Model. As noted in the appended Treasury Report[7], the risks can be considered either first or second order. First order risks are those which are fundamental to the Model being operable, while second order risks are not fundamental to the Model being operable but impact its uptake.

As in the appended Treasury Report, this RIA contemplates risks as either first or second order. First order risks in the RIA are those risks that the Department considers are critical to the viability of the Model, these differ slightly from the appended Treasury Report. Second order risks are those that are important to manage to ensure that the Model is robust, but do not threaten the fundamental viability of the Model.

First order risks are outlined here; second order risks are described in section 6.2.

First order risks:

Consumer / beneficiary protections

As a new Levy, it will be vital that a comprehensive disclosure regime is provided for in the legislation to ensure that beneficiaries and other interested parties (such as prospective purchasers of land/dwellings that are subject to a Levy) are aware of, and understand, the implications of the Levy. Legislation should include a disclosure regime that addresses mandatory disclosure requirements to beneficiaries and interested parties on request and mandatory public disclosure. A possible disclosure regime is set out in paragraphs 84-88 of the appended Treasury Report.

Beneficiary identification and allocation will be complex. It is intended that detailed policy guidance to assist in this will be issued.

There is a risk that a Levy payer could complain to the Commerce Commission given the natural monopoly characteristics of the Model. The Commission could decide to launch a 'Part 4' inquiry under the Commerce Act 1986 that recommends that the Minister of Commerce and Consumer Affairs impose economic regulation. Whilst the Ministry of Business, Innovation and Employment suggests that the risk of this occurring is small, it is a non-trivial risk that Ministers should be aware of.

Officials recommend that the best way to mitigate this risk is for the Minister of Commerce and Consumer Affairs to be specified in the legislation as one of the Ministers who takes the Order in Council through Cabinet and the Executive Council. This would ensure that

[6] The list of proposed costs eligible to be recovered through a Charge are detailed in the appended Treasury Report.

[7] Note that some risks identified in this RIA are similar as those in the appended Treasury Report. This RIA identifies additional risks.

the relevant Ministers are appraised and allows a consumer perspective to be included in decisions around the Order in Council.

Democratic accountability

There are democratic accountability considerations connected with granting a levying power to third parties. It is fundamental that the power to tax is authorised by Parliament. It is proposed that a Levy be authorised by an Order in Council, requiring Ministers of the Crown to recommend a Levy to the Executive Council. It is proposed that the Auditor-General has a statutory role to audit the financial statements of a SPV. Further, it is proposed that there will be a statutory monitor with step in powers to take over aspect of the management of the SPV, to ensure that the Levy is lawfully collected and applied. The Levy accountability risk may be less substantial in greenfield developments than in brownfield development as it is clear that residents have 'opted-in' to a development and charging scheme. It may also be mitigated to an extent by ensuring SPVs are consistent with local authority planning instruments and the Resource Management Act 1991. It is typical for levies to be set by Order in Council (New Zealand Parliament).

The Department and the Treasury also considered whether a delegated Minister or Crown body or a local authority should approve the use of a Levy. These options were considered to be less constitutionally robust, or counter to IFF objectives. Cabinet approval of a Levy, via and Order in Council is considered by officials as the most robust practical option.

Local authorities' willingness to use the Model

The future behaviour of local authorities towards using the Model will govern its ultimate success. We have taken steps to involve local authorities in the development of the Model, including:

- regular dialogue with high growth councils in relation to the Model;
- a series of workshops with officials from high growth councils to walk through our policy development proposals and solicit their feedback;
- engagement with officers of high growth councils to assess how the Model would work in practice with reference to real-life case studies; and
- Ministerial engagement with elected local authority members.

There remains a risk that local authorities may be slow or reluctant to adopt the Model. Issues that have been identified which may impact the willingness of local authorities to adopt the Model include:

- perceived loss of control of local authority responsibilities;

  concern over the affordability of the Levy for beneficiaries;
- concern over the ultimate owner of the SPV – high growth councils have indicated that they want the SPV to be owned by the Crown;
- difficulty adapting to use the Model; and
- objection to the Project itself (for example, a local authority may prefer urban growth did not occur in areas where a Levy is proposed).

The only way to completely address this risk is to override local authority decision making powers. This option is not considered appropriate by officials. This approach would be counter to the partnership objectives of the Urban Growth Agenda and carries significant risks to local authorities. Some of the potential risks include:

- substandard specification would likely be burdensome to councils and carry network risk;
- incentivising developers / SPVs to build plant or equipment that has a lower capital cost leaving more burdensome on-going costs to fall on the local authority, or have insufficient capacity to serve a catchment; and
- communities may not have the same level of say in how local authorities allocate scarce capital (removing accountability for).

This would also mean that the Crown would take on significant additional risk of project failure.

Additionally, for significant Projects where the Crown wanted to proceed without the agreement of the local authority, the most appropriate mechanism to do this would be through the Housing and Urban Development Authority (**HUDA**).

We propose to mitigate these risks by including a focused approval process for local authorities on the matters that they are most concerned about (financial impacts and vesting of assets).

Level of Government Support

For some projects there will be need for a Government Support Package (**GSP**) to support the Levy. The GSP will involve the Crown taking risks which would otherwise be borne by local authorities but cannot due to rating agency requirements. These risks could give rise to additional cost and lead to a request for the Crown to provide additional financial support. Mitigations include: independent negotiation of the GSP, monitoring, due diligence and the potential ability of the Crown to recover the GSP through varying the Levy.

Second order risks:

These risks are in relation to implementation, rather than the model. These are described in more detail in section 6.2.

- Unwilling beneficiaries
- Development incentives
- Incentives for local authorities
- Affordability and acceptability of the Levy
- Sufficient Project scale
- Underutilisation of the Model
- Ability for the Levy to cover the full cost of the Infrastructure
- Communication with local authorities and beneficiaries

Identify any significant incompatibility with the government's 'Expectations for the design of regulatory systems'.
The Model is consistent with the government's 'Expectations for the design of regulatory systems'.

Section C: Evidence certainty and quality assurance

Agency rating of evidence certainty?

The National Policy Statement on Urban Development Capacity (**NPS-UDC**) Housing and Business Assessments (**HBAs**) provide the best available evidence as to the scale of housing supply shortfalls in New Zealand's urban centres. These assessments show that while all high-growth urban areas are showing sufficient development capacity for housing in the short and medium term, there is evidence that much of this development capacity is at higher price points, with little affordable development capacity, particularly in Auckland. There are also capacity shortages in the long-term.

For example, Auckland has feasible development capacity of approximately 326,000 homes over the next 30 years (at sale prices average of $1.22 million for brownfield and $1.50 million for greenfield[8]), against projected demand of 407,000 additional households over this period (Auckland Council, 2017). This shortfall highlights an infrastructure deficit to support the anticipated housing demand.

We also know that many of New Zealand's high growth local authorities are at or approaching their debt limits, restricting the choices that they make about infrastructure provision.

The Treasury and Crown Infrastructure Partners have identified several projects that could be considered as viable to be funded and financed through the Model. These projects are listed in Appendix A of the appended Treasury Report.

The speed of policy development required has limited the ability to collect a sufficient evidence base to undertake a complete analysis on the availability of infrastructure to service urban development. This is to say that we do not have a clear understanding of the 'infrastructure deficit'.

However, it is well understood in urban economics that land supply is a key driver of house prices. In New Zealand, limited supply is leading to price distortions. Analysis from the Ministry for the Environment and Ministry of Business, Innovation and Employment indicates that house prices in Auckland are nearly three times their fundamental cost and the difference in value for a 600m^2 section in Auckland between urban and rural zoning is in excess of $200,000. (Ministry of Business, Innovation and Employment & Ministry for the Environment, 2018)

[8] By comparison, in Auckland, a KiwiBuild home cannot exceed $650,000 (Ministry of Housing and Urban Development, 2018).

The Model looks to remove the local authority financing constraint to providing local infrastructure. To the extent that this allows additional capacity or land to be serviced, this will help induce a level of competition between landowners. It also helps spread the cost of infrastructure over a longer time horizon, rather than being recovered through a developer contribution or other mechanism where the cost is capitalised into the sale price of a home. The IFF workstream will not resolve issues contributing to high urban land and house prices. It forms a part of a suite of interventions under the UGA aimed at improving New Zealand's approach to urban development in order to support housing affordability.

To be completed by quality assurers:

Quality Assurance Reviewing Agency:
The Department of Internal Affairs and the Treasury
Quality Assurance Assessment:
The Department of Internal Affairs' Regulatory Impact Analysis panel has reviewed the 'Infrastructure Funding and Financing' RIA (the RIA) in accordance with the quality assurance criteria set out in the CabGuide. This was a joint review by the Department and the Treasury. The panel considers that the information and analysis summarised in the RIA meets the quality assurance criteria.
Reviewer Comments and Recommendations:
The panel considers that the information and analysis summarised in the RIA meets the quality assurance criteria. The RIA uses clear, plain English to explain complex concepts in a technical area. There has been consultation with relevant stakeholders and the RIA identifies further consultation needed on specific issues as part of the detailed policy development phase. The RIA notes the context of the proposed approach within the broader Urban Growth Agenda framework and the analysis of the options in the RIA (supported by sub-options detailed in the appended Treasury Report) clearly articulate the risks and trade-offs involved. Time constraints have meant that officials have been unable to undertake a comprehensive assessment of the monetary costs and benefits of the proposed approach, however the RIA comprehensively identifies the range of costs and groups of beneficiaries of this proposed approach. This statement was prepared with a draft of the appended Treasury report, received 3 April 2019. The report may have been subject to changes since the panel's feedback.

Impact Statement: Infrastructure Funding and Financing

Section 1: General information

1.1 Purpose

The Department of Internal Affairs is responsible for the analysis and advice set out in this Regulatory Impact Assessment (**RIA**), except if otherwise explicitly indicated.

This analysis and advice has been produced for the purpose of informing:

- key policy decisions to be taken by Cabinet;
- final decisions to proceed with a policy change to be taken by or on behalf of Cabinet; and
- informing stakeholders.

Cabinet will be asked to consider the legislative charge model (**the Model**) and the powers necessary to enable the Model to be effective.

Scope

This RIA sets out options to overcome local authorities' constraints to funding and financing[9] local infrastructure to help improve the supply of serviced urban land and housing affordability. This RIA provides an assessment of the options of alternative funding and financing approaches for local government to increase the responsiveness of housing related infrastructure provision to help improve land supply and housing affordability.

Further detail and sub options analysis on various aspects of the proposed approach can be found in the appended Treasury Report.

Stakeholders

This RIA also helps inform stakeholders about the proposed Model and how it may impact on them. These stakeholders are:

- Local Authorities
- Central Government Agencies
- The Local Government Funding Agency
- Contractors, consultants and developers
- Home/land owners and buyers – note, due to time constraints, we have not consulted with this cohort.

Time constraints meant that wide consultation with all stakeholders was not possible. However, robust targeted consultation was held. It is envisaged that these stakeholders will have an opportunity to have their say through the select committee processes, should legislative change be progressed. Further targeted consultation will also be undertaken during the legislative drafting process.

[9] Financing refers to accessing the capital required to meet the upfront costs of the infrastructure, while funding refers to the revenue streams to pay off that capital over time.

Context

The Infrastructure Funding and Financing work programme (**IFF**) is one pillar of the Urban Growth Agenda (**UGA**). The main objective of the UGA is to improve housing affordability, underpinned by affordable urban land.

The Urban Growth Agenda

The UGA's main objective is to improve housing affordability, underpinned by affordable land. It is designed to address fundamentals of land supply, development capacity and infrastructure provision by removing undue constraints. To achieve this there are a series of integrated work programmes designed to improve how New Zealand plans, develops, manages, and funds and finances urban growth.

The UGA has five interdependent pillars:

- infrastructure funding and financing — to enable a more responsive supply of infrastructure and appropriate cost allocation
- urban planning — to allow for cities to make room for growth, support quality-built environments and enable strategic integrated planning
- spatial planning (initially focused on Auckland and the Auckland-Hamilton corridor) — to build a stronger partnership with local government as a means of developing integrated spatial planning
- transport pricing — to ensure the price of transport infrastructure promotes efficient use of the network
- legislative reform — to ensure that regulatory, institutional and funding settings are collectively supporting UGA objectives.

More information on the UGA can be found at https://www.hud.govt.nz/assets/Urban-Development/Urban-Growth-Agenda/urban-growth-agenda-cabinet-paper.PDF.

1.2 Key Limitations or Constraints on Analysis

The government's aspiration to have enabling legislation passed in 2019 has limited the time available to complete options analysis as comprehensively as preferred by officials. Consequently, there are limitations to the analysis in this assessment:

- A comprehensive assessment of the monetary costs and benefits has not been feasible in the time available.
- Consultation has been largely limited to officers of four high-growth local authorities: Hamilton City Council, Auckland Council, Queenstown Lakes District Council, and Tauranga City Council. Officers of these high growth councils have indicated support for new financing and financing tools that resolves existing financing and funding constraints. Consultation was also undertaken with other growth Councils and Local Government New Zealand, however this was more limited in nature. These other growth Councils included: Waikato District Council, Waipa District Council, Western Bay of Plenty District Council, Wellington City Council and Christchurch City Council.

- Consultation with homeowners and the remaining local authorities has not been possible. These potentially affected parties will have an opportunity to have their say through the select committee process.

Cabinet direction

- In 2018, Cabinet considered the IFF work programme. Three workstreams were considered as part of the IFF work programme:
    - **Workstream 1**: The design, creation and implementation of alternative financing models to be used primarily for investment in bulk infrastructure including three waters and transport to support housing and urban development;
    - **Workstream 2**: Investigate easing the existing local authority debt constraints with the Local Government Funding Agency (**LGFA**); and
    - **Workstream 3**: Assess whether the existing targeted rates/development contributions regime can be utilised more effectively to better recover the cost of infrastructure.

  The first workstream, alternative financing models, is the immediate priority and focus of this RIA. Work on the other two workstreams is yet to start. There is merit in progressing these further workstreams, as detailed in section 3.1. These options will be progressed at a later stage.

- Cabinet directed the Treasury and the Department to consider the legislative and policy changes needed to enable the use of alternative financing mechanisms, such as Special Purpose Vehicles and report back in early 2019. This is the priority workstream (workstream one). This RIA informs that report back. DEV-18-MIN-0211 refers.

- Cabinet also set an expectation that officials not examine the option of central government providing funding for local government infrastructure. DEV-18-MIN-0211 refers.

Responsible Manager (signature and date):

____

Richard Ward | Partnership Director

Central Government Local Government Partnerships

The Department of Internal Affairs

10/05/2019

Section 2: Problem definition and objectives

2.1 What is the context within which action is proposed?

Local authorities are responsible for meeting the current and future needs of communities for infrastructure, local public services and performance of regulatory functions in a way that is cost-effective for households (Local Government Act 2002). This includes bulk local infrastructure such as three waters, local roads, transport, and community infrastructure such as parks and libraries.

Local infrastructure is crucial to enabling economic activity, housing supply and well-functioning communities. The ongoing costs of provision and maintenance of this infrastructure creates significant challenges for councils (LGNZ, 2017). Financial constraints, increasing community expectations, growth pressures and historic under-investment are exacerbating these challenges.

Local authorities spend over $4 billion annually building, maintaining and improving assets (NZPC, 2018). This is funded through a mixture of tools such as rates, user charges, grants/subsidies and development contributions[10]. Financing of projects is typically via local authority borrowing. This approach means the cost of the asset aligns with benefit realisation over the life of the asset. Local authorities can deliver local infrastructure earlier than if they paid the full capital cost upfront and can use their revenue streams to meet debt-servicing obligations. There are several constraints on local authorities' borrowing capacity. These are described in section 2.2 and section 2.3.

Population growth in New Zealand's urban centres has been outpacing forecasts. Auckland, for example, is now expected to be home to around two million people by 2028. That means the number of people in Auckland will grow by an amount equivalent to the population of Tauranga every three years.

These population shocks, coupled with financing constraints and historic under-investment have meant that local infrastructure provision has not kept pace with demand, placing pressure on urban land and housing supply. With the current financing tools available to local authorities, this shortage appears likely to remain. The NPS-UDC HBAs highlight housing shortfalls in Auckland, Tauranga, Hamilton and Christchurch over the long-term, but not in the short or medium term[11]. These shortages are contributing to high housing costs. In Auckland, house prices are close to three times their fundamental cost, with land value accounting for 67% of the average Auckland dwelling capital value.

The government has deployed tools for local authorities to overcome these constraints. In 2017 the government introduced the Housing Infrastructure Fund (**HIF**), an interest-free loan designed to facilitate the delivery of local infrastructure. However, the HIF ultimately impacted on local authority balance sheets. Following this, Crown Infrastructure Partners (**CIP**) was established to facilitate a contractual special purpose vehicle to finance bulk local infrastructure development using existing legislation. The CIP model, while successful, is based on negotiated terms between developers, landowners and the local authority. The Model seeks to evolve the CIP alternative financing structure through

[10] The Local Government Act 2002 and Local Government (Rating) Act 2002 regulate how infrastructure is provided, funded and financed. These regulations are explained in section 2.2, below.

[11] See section 2.2 below for further detail on the NPS-UDC.

legislation to be simpler, more accessible, scalable and more appealing to financiers.

If these challenges are not resolved, local authorities will continue to face financial constraints when delivering local infrastructure. This will mean that local infrastructure to support housing and urban development is not provided in a timely manner. Housing and urban development will continue to face the same constraints as today, continuing to constrain land markets. Housing affordability would be unlikely to improve under the status quo.

2.2 What regulatory system, or systems, are already in place?

The regulatory system for local authority infrastructure is complex and there are several interdependencies between various pieces of legislation. The Urban Growth Agenda aims to reform this broader system.

Local authorities are required to meet the current and future needs of communities for good quality local infrastructure (Local Government Act 2002). The powers and regulations for local authorities to plan and provide for infrastructure to service the current and future needs of their communities are set out in several laws and regulations. The core regulations are described below.

Infrastructure planning/provision

Local Government Act 2002

The Local Government Act 2002 (**LGA**) is the core legislation that sets out the role and responsibilities of local government. It requires local authorities to meet the current and future needs of communities for good quality local infrastructure, local public services, and performance of regulatory functions.

The main LGA requirements relating to infrastructure provision are set out in table one below. These requirements ensure that local authorities' financial positions, expenditure proposals and consequential impacts on rates and debt are transparent and balanced.

Table one: Local Government Act 2002 provisions relating to infrastructure

Process	Purpose
Long-Term Plan	To plan activities and service provision over a timeframe of at least 10 years. As part of Long-Term Plans, local authorities must prepare and adopt a financial strategy. The Plan's purpose is to facilitate prudent financial management, and to provide transparency about the effect of funding and expenditure proposals on rates, debt and investments.
Infrastructure Strategy	To set, over at least 30 years, the local authority's approach to the development of new assets and the management of existing assets.
Annual Plan and Annual Report	To set out and report on planned activities, revenue and expenditure for a financial year.

(Source: Ministry for the Environment, 2018)

The LGA enables councils to require a development contribution for contributing a portion of the capital costs of constructing or extending network infrastructure and community infrastructure to service growth. New subdivisions and more intensive developments in existing areas can impose significant new costs on existing ratepayers. Local authorities can decide that developers and their clients should bear the costs of new local infrastructure such as reserves, roads, water and wastewater infrastructure, and community facilities.

National Policy Statement on Urban Development Capacity

The National Policy Statement on Urban Development Capacity 2016 (**NPS-UDC**) directs local authorities to provide sufficient development capacity in their resource management plans to meet demand for housing and business space. 'Development capacity' refers to the amount of development allowed by zoning and regulations in plans that is supported by infrastructure, with different requirements around infrastructure servicing in the short, medium, and long term.

The purpose of a national policy statement is to state the objectives and policies for matters of national significance that are relevant to achieving the purpose of the Resource Management Act 1991. The Governor-General in Council may, on the recommendation of the Minister for the Environment, approve a national policy statement.

The NPS-UDC requires that at any given time, short-term capacity must be feasible, zoned and serviced with development infrastructure. Medium-term capacity must be feasible, zoned and either serviced with development infrastructure, or development infrastructure identified in a long-term plan under the LGA. Long-term capacity must be feasible, identified in relevant plans and strategies. The development infrastructure to support it must be identified in an infrastructure strategy under the LGA. Local authorities must also be satisfied that other infrastructure required to support urban development is likely to be available.

For medium to high-growth areas, local authorities must provide an additional margin of feasible development capacity above projected demand of at least: 20% in the short and medium term; and 15% in the long term. Local authorities shall ensure that at any one time there is sufficient housing and business land development capacity according to the below:

Short-term (0-3 years)	Development capacity must be feasible, zoned and serviced with development infrastructure.
Medium-term (3-10 years)	Development capacity must be feasible, zoned and either: • serviced with development infrastructure; or • funding for the development infrastructure required to service that development capacity must be identified in a Long-Term Plan required under the Local Government Act 2002.
Long-term (10-30 years)	Development capacity must be feasible, identified in relevant plans and strategies, and the development infrastructure required to service it must be identified in the relevant Infrastructure Strategy required under the Local Government Act 2002.

(Source: Ministry for the Environment, 2016)

Local authorities have provided feedback that the requirement to provide infrastructure to meet short-, medium- and long-term capacity with a surplus margin places a significant fiscal burden on them. Local authorities have incurred increasing debt over the years, and they face constraints on their ability to take on more debt to provide local infrastructure to greenfield areas and future development capacity. Some councils have advised that the timing and sequencing of the NPS-UDC deliverables are difficult to achieve, or unachievable.

Local authorities in high-growth areas also need to produce a Future Development Strategy (**FDS**) that demonstrates there will be sufficient, feasible development capacity in the medium- and long-term. The FDS must:

- identify the location, timing and sequencing of future development capacity for the long-term, including both future greenfield areas and intensification opportunities in existing urban environments; and
- balance certainty about future urban development with being responsive to demand.

For high-growth local authorities, financing is a significant constraint on their ability to deliver local infrastructure. The Model provides an additional financing tool to help ensure the requirements of the NPS-UDC are met, by ensuring infrastructure can be responsive to demand and financed to support additional development capacity.

Financing

Local Government Funding Agency

The Local Government Funding Agency (**LGFA**) is a Council Controlled Organisation (**CCO**) operating under the Local Government Act 2002. There are 31 shareholders, comprising the New Zealand Government (20%) and thirty councils (80%).

The LGFA's core objective is to provide debt financing for local authorities on terms that are more favourable than if they raised the debt directly (LGFA, 2019). To help meet this objective, the LGFA aims to maintain a credit rating equal to the New Zealand Government sovereign rating where both entities are rated by the same Rating Agency (that is, if the government holds a credit rating of AA+ from *Standard and Poor's,* the LGFA aims to maintain an equivalent rating).

As part of the LGFA's risk management policies and to help keep borrowing costs to a minimum, participating local authorities must adhere to certain financial covenants:

Financial covenant	Lending policy	Foundation policy
Net debt / total revenue	<175%	<250%
Net interest / total revenue	<20%	<20%
Net interest / Annual rates income	<25%	<30%

Non-compliance with the financial covenants will either preclude a local authority from borrowing from the LGFA, or in the case of existing local authority borrowers trigger a review.

Local authorities with a long-term credit rating of 'A' equivalent or higher will not be required to comply with the lending policy covenants in the above table and can have bespoke financial covenants that exceed the foundation policy covenants outlined above only with the approval of an Ordinary Resolution of shareholders[12].

Financial Prudence Regulations

Financial prudence regulations were introduced under the Local Government Act 2002 in 2013. These require councils to report on planned and actual financial performance against financial prudence benchmarks. Currently no high-growth local authorities are approaching these benchmarks (Treasury Report T2018/1087 refers). The Benchmarks are as follows:

Benchmark	**Condition**
Debt affordability	Actual or planned borrowing is within the quantified limits on borrowing set by the authority in its financial strategy.
Debt servicing	Yearly borrowing costs ≤ 10% of revenue (15% for high growth councils).
Debt control	Actual net debt at the end of the year is ≤ planned net debt.

Source: The New Zealand Productivity Commission (2015)

Funding

The Local Government (Rating) Act 2002

The Local Government (Rating) Act 2002 (**LGRA**) sets out the powers available to local authorities to set and collect rates to fund their activities. It requires that rating decisions are made transparently and in consultation with the community. It enables local authorities to choose how they raise revenue from the community to fund activities. The main options available are: general rates (with or without differentials, explained below), targeted rates, and user charges.

General rates are typically used where the community as a whole meets costs of particular functions of the relevant local authority. These are taxes rated on property value, according to a formula set annually by the local authority. The rates attributable to a property vary according to a property's value. Each local authority decides if the rates will be assessed on land value, capital value or annual value of the property. General rates may have 'differentials' applied, where the local authority can take into account property value, location, area, use, and activities allowed for under the Resource Management Act.

Under the LGRA, local authorities also have the flexibility to set **targeted rates** to fund local infrastructure and services that benefit identifiable ratepayers. Targeted rates are conceptually similar to the proposed Model, however a multi-year targeted rate cannot be struck under the LGRA. Factors which can be used for calculating targeted rates are: land value; improvement value; capital value; annual value; total land area: area of land paved; sealed or built on; area of land protected; area of floor space of buildings; number of connections; number of water closets and urinals; number of separately used/inhabited

[12] An ordinary resolution is a resolution that is approved by a simple majority of the votes of those shareholders entitled to vote and voting on the question.

parts; and extent of provision of services.

The LGRA also provides for local authorities to use direct cost recovery mechanisms such as **user charges**, or volumetric charges on drinking water.

Fit for purpose

For local authorities who experience moderate growth or stable ratings bases and are below their debt constraints, the existing funding and financing regimes are effective. However, for high growth local authorities the existing regime is constraining their ability to fund and finance infrastructure to support housing and urban development.

The Model is focussed on the financing system but is supported by enabling a new funding stream. The Department considers that work is needed to understand how aspects of the LGA, LGRA and LGFA could be optimised to assist local authorities in providing infrastructure in a timelier manner. It is proposed that this is examined in further detail at a later stage, section 1.2 refers.

2.3 What is the policy problem or opportunity?

Housing affordability in New Zealand has been declining. One of the government's key priorities is to improve housing affordability. The policy and reform vehicle to influence housing affordability is the Urban Growth Agenda (refer section 1).

While IFF is one pillar of the UGA, it will not resolve the housing challenges on its own. A suite of interventions is needed. The IFF pillar is designed to support UGA objectives by providing a more enabling funding and financing environment for local authorities that supports more responsive provision of local infrastructure that underpins land supply, housing growth and urban development generally.

This is because the current institutional settings for local authorities to fund and finance bulk local infrastructure are delivering sub-optimal outcomes. Following a period of sustained population growth in New Zealand's urban centres, some local authorities are up against financing constraints. These constraints are preventing them from providing local infrastructure capacity to increase land supply and enable housing development.

Significant population growth requires local authorities to support the development of new communities, or to expand the capacity of existing communities. This necessitates significant capital investment in bulk network and community infrastructure, such as three waters, roads, public transport and parks. These investment demands are outstripping local authorities' ability and willingness to take on further debt, meaning there are investments that can be funded over time, but not financed from local authority balance sheet, preventing them from providing the necessary local infrastructure to service demand.

Currently, local authorities fund and finance bulk local infrastructure using a mix of revenue tools (such as general and targeted rates and central government subsidies) and financing tools. There are a variety of 'hard' constraints (legislative and regulatory) on debt and limits on rating powers as well as 'soft' constraints on local authorities.

Hard constraints are regulated and legislative debt ceilings. High growth councils are close to their maximum debt levels (with LGFA debt covenants being 250% of revenue). 'Soft' constraints are driven by an unwillingness of existing communities to incur debt, pay higher rates, or see a credit rating downgrade of the local authority for the benefit of another.

To help manage these constraints, local authorities typically sequence local infrastructure on a 'just- in- time' basis to manage financing burden and development risk. Local authorities can therefore be unable or unwilling to fund and finance large investments ahead of demand. As a result, economically viable projects are not proceeding, leading to a shortage of serviced, 'ready to go' urban land for development. This is contributing to uncompetitive urban land markets, creating "extremely high and growing [house] prices" (NZPC, 2017).

The challenge of providing local infrastructure is magnified by underlying institutions and incentives. These include:

- local infrastructure investments tend to be large, lumpy and irreversible, with long lead times and the risk of stranded assets if forecast demand does not eventuate;
- the misalignment of costs and risks creates a strong disincentive for local authorities to invest in local infrastructure ahead of anticipated demand pressures and instead to provide local infrastructure on a 'just-in-time' basis;
- the current financing structure puts minimising the cost of borrowing as the key financing priority and removes the ability of individual local authorities to move beyond existing debt limits. This can become an absolute barrier to investment, but also leads to significant competition for available financing between growth infrastructure and other local authority investment aspirations;
- this leaves existing ratepayers carrying the risk of financing and funding, at least in part, as providing for growth often involves expenditure both at the margin and at the network level; and
- the fact that many major local infrastructure investments have multiple purposes, and are not exclusively to provide for growth, means that funding is constrained by the ability of the local authority to fund and finance the non-growth component of the investment. Investment in light rail investment that supports brownfield development, and services existing residents is a good example of this.

A financing structure that overcomes local authorities' borrowing constraints will enable new housing developments to be completed sooner than might otherwise be the case if left to local authorities to finance under current institutional arrangements. The objective is to remove local infrastructure financing as a barrier to housing developments proceeding.

Through consultation, the Treasury and the Department have worked with local authorities to identify viable large scale projects that could proceed under the Model. Local authorities have been highly engaged and we have jointly identified a potential pipeline of large projects (over $50 million), that would support significant housing development (over 1,000 homes).

The successful development of new IFF tools would:

- allow debt to be leveraged from revenue streams independent of a local authority;
- make the viability of the Project the determinant of whether to proceed, removing

the trade-offs which local authorities often make when allocating scarce capital;

- provide greater rigour in the allocation of risk and costs to the appropriate parties;
- allow viable Projects to proceed outside of local authorities' borrowing constraints and allows the system to be better aligned to anticipated urban demand; allow costs to fall on the communities and homeowners who benefit from the new local infrastructure;
- provide a pipeline designed to allow new capital to flow into the local infrastructure system;
- provide price signals so that growth occurs where the provision of local infrastructure is most cost efficient; and
- open the system wider to developer-led growth.

2.4 Are there any constraints on the scope for decision making?

Cabinet has agreed an IFF work programme which included prioritising the policy and legislative developments needed to enable an alternative financing mechanism. Two complementary workstreams that look at expanding local government borrowing capacity and optimising the existing local authority funding and financing toolkit were also agreed, however work on these will be progressed at a later date (refer options one and three in section 3.1).

Cabinet has ruled out directly funding local infrastructure. This would require the Crown to materially change (in the short or long term) the approach to financing of local government infrastructure and potentially change the core purpose of local authorities. It may also require the Government to either not fund other central government priorities or to operate outside its budget responsibility rules.

The timeframes for delivering the RIA and related policy advice have been short. Consequently, some options may not be fully developed or consultation with stakeholders has not occurred to the level desired. Please refer to section 2.5 for further detail.

Interdependencies

There is a significant amount of work underway across government that will influence New Zealand's institutional infrastructure arrangements. Key related policy initiatives are outlined below.

Urban Growth Agenda

The IFF work programme is one pillar of the government's UGA aims to improve housing affordability for New Zealanders by addressing the fundamentals of land supply, development capacity and infrastructure provision. The remaining four pillars are Urban Planning, Spatial Planning, Transport Pricing, and Legislative Reform – collectively the five pillars are designed to improve the efficiency and responsiveness of the New Zealand planning system.

There are significant interdependencies between the pillars. For example, the *Spatial Planning* pillar will help better inform where development will/will not occur, which in turn assists in identifying infrastructure needs and prioritisation. The IFF pillar provides the means to ensure the necessary infrastructure can be progressed in a timely manner. The IFF programme itself can only go so far in addressing the goals of the UGA. Wider reform is needed to address underlying incentive issues.

Three Waters Review

The Three Waters Review is a multi-agency project led by DIA. It has close linkages with a range of other work programmes including the IFF pillar of the UGA.

Looking across the system, the best evidence available indicates there are system-wide challenges facing three waters provision. A key challenge identified is the funding and financing to upgrade local infrastructure. Many councils are struggling to fund plant and pipe infrastructure to the level required to meet standards and community aspirations, keep pace with population growth, and build resilience against natural events.

For many smaller councils, there is no clear way forward given the scale of the challenges. There is also a relationship with debt levels, with internally and externally imposed debt restrictions contributing to some of the funding and financing challenges. Cabinet agreed in November 2018 to the next phase of the Three Waters Review including reporting back in late 2019 on service delivery options.

Analysis and advice developed for the IFF work programme will be relevant and inform the structuring, funding and financing of various service delivery options to address the identified funding and financing challenges in the Three Waters space.

A new Independent Infrastructure Body

The broader infrastructure system is also undergoing significant change – the government has announced a new independent infrastructure body that will help develop New Zealand's infrastructure strategy, be a centre of excellence to support procurement and delivery of major infrastructure projects, and 'market' New Zealand's infrastructure pipeline.

Local Government Funding and Financing Inquiry (Productivity Commission)

In May 2018, Cabinet directed the Productivity Commission to conduct an inquiry into local government funding and financing. The scope of the inquiry includes the adequacy of the current funding tools and the use of these tools.

Any outcomes from the IFF work programme will be fed into this broader review. The Terms of Reference of this inquiry state that it should complement and receive existing work (e.g. the Three Waters Review, and the IFF), rather than duplicating it.

Building system legislative programme

While the IFF work programme may enable more responsive funding and financing of local infrastructure Projects, the uptake and delivery of these Projects will be impacted by construction sector capacity. This may be mitigated through the building system legislative reform programme.

2.5 What do stakeholders think?

There are a significant number of stakeholders in local authority infrastructure. Key stakeholders directly involved of affected by provision, funding and financing of local authority infrastructure include:

- Local Authorities
- Central Government Agencies
- The Local Government Funding Agency
- Contractors and developers
- Home/land owners and buyers – note, due to time constraints, we have not consulted with this cohort

Due to time and resource availability when preparing this RIA and related policy advice, consultation with home/land owners and buyers was not feasible. As such, consultation was targeted to ensure that we would develop an alternative financing model that worked and would be appealing to critical stakeholders, local authorities in particular.

If legislative change is progressed, the cohorts that we did not directly engage with will be able to have their say through the select committee process. Ongoing consultation through the supporting policy design phase will also be undertaken.

Local Authority Consultation

Throughout the policy development phase, the Treasury and the Department have engaged extensively with officers of high growth councils (Auckland Council, Hamilton City Council, Queenstown Lakes District Council and Tauranga City Council). Officers of the high growth councils support the IFF approach, recognising the need to develop alternative financing mechanisms that enable them to support growth.

They have raised some policy issues, such as the nature of local authority involvement in approving a Levy, Project, or specifying asset requirements. These issues will need to be worked through during the more detailed policy development phase and addressed prior to implementation. This is discussed further in the appended Treasury Report.

The Department and the Treasury are continuing to work closely with the councils and have widened engagement to include other Councils (Waipa District Council, Wellington City Council, Christchurch City Council, Western Bay of Plenty District Council and Waikato District Council) and Local Government New Zealand.

Central Government Agency Consultation

There are several central government agencies that have an interest in local authority local infrastructure provision. These agencies are: The Ministry for the Environment, the Ministry for Housing and Urban Development, the Ministry of Transport and LINZ.

The Department and the Treasury have held a number of central government agency workshops to test the preferred approach. These workshops have also included the New Zealand Transport Agency.

Agencies are supportive of the IFF problem definition and proposed approach and note the interdependencies with other UGA pillars and cross government work programmes. For example, the Model will need to complement the proposed Housing and Urban

Development Authority.

Local Government Funding Agency

LGFA recognise the need for alternative financing models and are supportive of the legislative model being developed. The agencies are in discussions with LGFA about the role they could play in the Model through an ownership interest or through arranging the capital required.

Other stakeholders (developers, contractors, large land owners, financiers and consultants)

Through Infrastructure New Zealand (the peak body for the infrastructure sector), officials have consulted with a range of stakeholders. This has included developers/contractors, large landowners, financiers and consultants. That consultation has included a full day workshop as well as individual meetings with particular stakeholders.

In addition, CIP has led discussions with identified large landowners where the use of the Model may be applicable. Those discussions were focussed on how the Model would practically apply to a specific development.

Advisers to the Treasury and the Department (along with Crown Infrastructure Partners) also undertook engagement with developers at two levels:

- High-level – explaining the potential financing models (contractual and legislative) and flagging the potential for future engagement.
- More detailed – more detailed discussions, working through projects that may be candidates for the models

The response to the high-level engagement was positive with developers acknowledging the need for alternative financing. Concerns raised were around beneficiary identification and equity, as well as affordability of the Levy. These concerns are addressed in this RIA (see section B and 6.2) and the appended Treasury Report.

Developers that have been involved in more detailed discussions have indicated appetite to commit resource and continue involvement with the existing contractual model or the proposed Model with the adviser and CIP. As well as indicating support for the principles underpinning the models, this appetite may reflect that these developers have projects that are somewhat stalled, and they wish to progress the projects quicker. The concerns raised include the allocation of construction risk and project viability in terms of total cost and how this is allocated across beneficiaries, the local authority and other contributors such as NZTA. These risks are addressed in different ways either through contract or in legislation. For example, while there are a range of costs that can be included in a Levy, it may not be practical to include all of these in a Levy.

Further consultation

If legislative change progresses, further consultation will be undertaken through the select committee process, and further direct engagement with stakeholders during detailed policy design. Other interested parties will also be able to have their say through the select committee process.

Māori / iwi interests

Further work and consultation is required in relation to the Model's application to Māori land. We note that the powers of the proposed urban development agency are restricted in relation to sensitive Māori land. A similar approach may be suitable for the proposed legislation. LINZ is leading a cross agency work programme to consider the application of the Public Works Act to Māori land generally. The outcome of that work may provide a suitable answer to the application of the Model to Māori land.

Section 3: Options identification

3.1 What options are available to address the problem?

There are several options that will increase the funding and financing capacity of local authorities. However not all options support the broader IFF and UGA objectives.

These options include funding infrastructure through general taxation, increasing general rates, user chares and a long-term charge model. These are illustrated by figure one, below. Ministers have ruled out further direct crown funding (general taxation) to fund local government infrastructure.

Figure one: Intervention options, beneficiary pays scale

For the purposes of this RIA and to support Cabinet direction, we have assessed the following:

1. expanding local authority debt capacity
2. enabling / extending the use of alternative financing mechanisms, such as project finance to enable long-term charges
3. optimising the existing local government funding and financing toolkit

These options have been assessed against the criteria described in section 3.2, below.

Each option provides local authorities, to varying degrees, additional capacity to finance local infrastructure. These options are not mutually exclusive. A mix of these tools would provide local authorities with an expanded infrastructure funding and financing toolkit to support housing development.

1. Expanding local authority debt capacity

As described in section 2.3 above, local authorities face several regulatory (hard constraints, such as debt covenants) and self-imposed debt constraints (soft, behaviour/incentive-based constraints). The regulatory constraints are considered 'hard' constraints as there are consequences to breaching these, such as increased borrowing costs. The self-imposed constraints are 'soft' constraints as they are a result of political incentives.

The Treasury and the Department have considered expanding the debt capacity of local authorities by easing the below 'hard' debt constraints:

- Local Government Funding Agency (**LGFA**) borrowing covenants. These covenants act as measures to maintaining credit ratings to minimise the cost of borrowing.
- The financial prudence regulations set out in the Local Government (Financial Reporting and Prudence) Regulations 2014 (the **Benchmark Regulations**).

These are detailed further in table 2, below.

Table 2: Local Government Funding Authority and Local Government Act debt constraints

LGFA Debt Covenants	
Councils with a credit rating equivalent to 'A' or better	**Councils without an external credit rating**
Net debt / total revenue is less than 250%	*Net debt / total revenue is less than 175%*
Net interest / total revenue is less than 20%	*Net interest / total revenue is less than 20%*
Net interest / rates are less than 30%	*Net interest / rates are less than 25%*
Benchmark Regulations	
Benchmark	**Condition**
Debt affordability	*Actual or planned borrowing is within the quantified limits on borrowing set by the authority in its financial strategy*
Debt servicing	*Yearly borrowing costs ≤ 10% of revenue (15% for high growth councils)*
Debt control	*Actual net debt at the end of the year is ≤ planned net debt*

The LGFA debt covenants are a binding constraint for high-growth local authorities, in particular, the debt-to-revenue covenant preventing them from borrowing more than 250% of their revenue. The Treasury suggests that in absence of these, most local authorities would be able to borrow twice current levels before breaching the Benchmark Regulations (T2018/1087 refers). By comparison, utility companies can have net debt-to-revenue ratios of 700-1400%.

Desktop analysis by the Treasury (T2018/1087 refers) indicates that relaxing the LGFA covenants would provide further borrowing capacity of approximately $250 million for some high-growth councils. Auckland Council would see an additional borrowing capacity of around $2 billion become available under this option. For comparison, Auckland Council is forecasting capital expenditure of around $26 billion over the next decade (Auckland

Council, 2018).

Relaxing these covenants is not without risk as increased local authority debt could place further demands for Crown support if local authorities were in financial distress. This approach would require working closely with the LGFA and local authorities to understand these risks in detail. For example, moving beyond the existing suite of covenants would likely result a credit rating downgrade for the LGFA, which would increase the cost of borrowing for all participating councils. The LGFA also wishes to maintain a credit rating equivalent to the New Zealand government[13] and altering the debt covenants would jeopardise this.

While altering or removing the LGFA covenants would provide further debt capacity for local authorities, it would only push the boundary. This option has limited ability to support the policy objectives associated with IFF. Project proponents, whether council or some other person, would still need to compete for scarce capital. Providing further debt headroom:

- does not allow for incentives to be realigned to supporting growth.;
- does not provide a secure and long-term revenue stream;
- does not transparently allocate project costs and risks to the most appropriate parties; nor
- is it accessible by any project proponent.

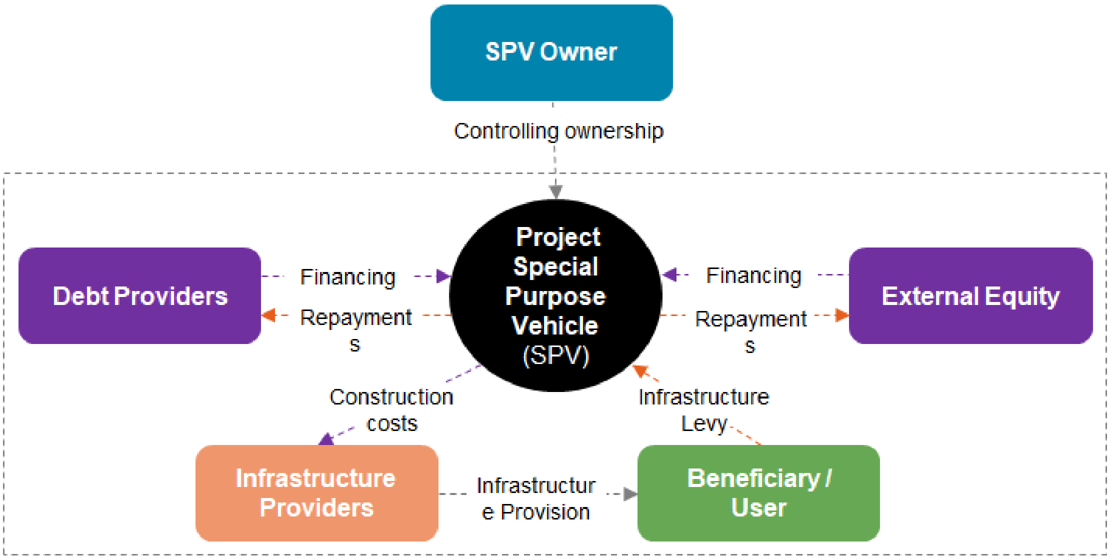
2. Enabling alternative financing mechanisms (preferred option)

Alternative financing (also known as project financing), offers a financing model that overcomes 'balance sheet constraints'. Project finance is commonly used by the infrastructure sector in other jurisdictions and is a familiar tool to financiers. In New Zealand the closest comparable structure used by local authorities and central government are Public Private Partnerships.

Project finance is the financing of an infrastructure project through an entity (a Special Purpose Vehicle). Generally a SPV will have a combination of debt and equity. The debt and equity provided are repaid from the cash flow generated by the project. Figure one, below, provides an illustrative overview of this model.

[13] The LGFA aims to maintain a credit rating equal to the New Zealand Government sovereign rating where both entities are rated by the same Rating Agency (i.e., if the government holds a credit rating of 'AA+' *from Standard and Poor's*, the LGFA aims to maintain an equivalent rating).

Figure one: illustrative overview of how an SPV may work



Typically, a project proposer (a local authority, or some other entity), would establish a Project SPV that raises the finance required to deliver a project. The finance is raised on the back of a confirmed revenue stream generated by the project (via a charge or fee), rather than the asset being constructed. The SPV has responsibility to deliver the project, but the assets vest back to the project proposer following the infrastructure construction.

Because the debt and equity are repaid via the cash flows generated by the project, if a project fails, creditors and equity providers have limited recourse to the project proposer's assets and cash flows. This allows a project and the associated debt (and cash flows) to be ring-fenced from a project proper's balance sheet. This can be applied in relation to the debt constraints faced by local authorities.

For a project to be viable under this model, the cash flows generated need to be sufficient to repay the debt and equity, meaning the economic benefits must exceed the economic costs. This critical test helps ensure net beneficial projects can proceed using the alternative model. In the context of local authorities having scare capital, project finance partially mitigates the need to trade off one capital project over another, where the revenues are sufficient to cover costs.

At a high-level there are two charge models that ensure that funding and financing of a local infrastructure Project is independent of local authorities and thus isolated from their borrowing constraints. The two variants are contractual (non-legislative) and legislative.

Contractual (non-legislative) charge model (existing)

In November 2018, the Government (via Crown Infrastructure Partners (**CIP**)) and Auckland Council announced the Milldale development (**Milldale**) north of Auckland. Milldale involved the use of an alternative financing and funding mechanism, including the use of a targeted charge on beneficiaries of the development. This charge covers a period of 30 years and was based on negotiation with the developer who also owned the land being developed. The developer agreed to place an encumbrance on the land titles which requires the owner to pay an annual infrastructure payment to CIP (a fixed revenue stream, secured against the land by the encumbrance).

While the Milldale model was able to access long term financing that did not impact on local authority debt constraints, it has limitations as to its replicability. This is because the CIP model relies on cooperation of a large developer to be effective. This approach is difficult to replicate in a situation where there are many beneficiaries or developer may be unwilling or unable to contribute to contribute. A large number of developments in New Zealand involve multiple developers with different interests and objectives.

Legislative Charge Model

A legislative charge model (**the Model**) that enables a party other than a local authority to levy a long-term charge to fund and finance a local infrastructure project overcomes some of the shortfalls of the contractual charge model above. The use of a legislative charge means that identified beneficiaries are required to pay the charge/Levy, much like homeowners being required to pay local authority rates, meaning the Model can be more easily applied to areas where there are multiple beneficiaries or landowners.

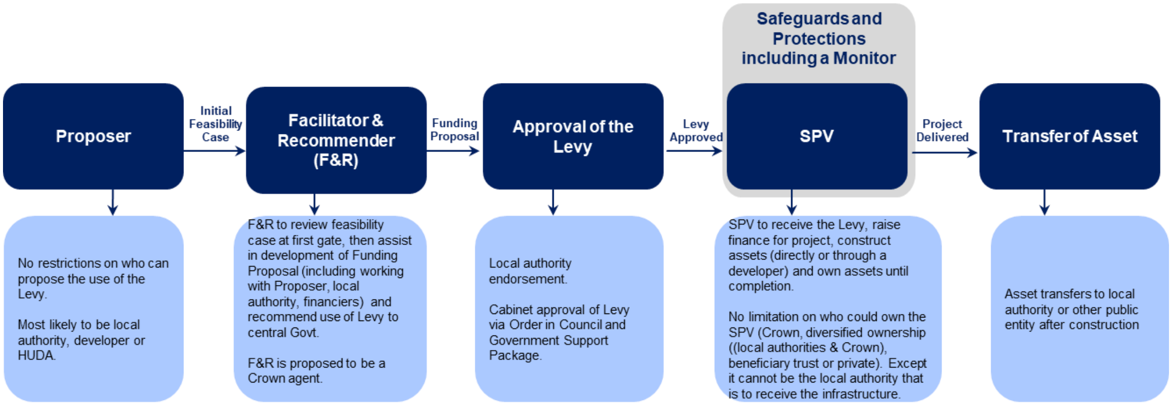
Legislation will provide a broad ability for the Model to deliver economic, social and community infrastructure. The legislation will also allow the Model to be used for a limited range of Crown-owned infrastructure (particularly rail, light rail and environmental protection works). The legislation will make it clear that the Model is not to be used for other Crown-provided infrastructure such as schools, police and fire stations, hospitals and the like. Consultation is continuing to inform the design of the Model.

There are several key elements to the Model:

- **Funding**: a Levy is applied to the identified beneficiaries of the local infrastructure (similar to targeted rates). This Levy is levied by an SPV, not the local authority. It will typically apply for around 30 years.
- **Finance**: the Levy will be used by a new entity (a SPV) to raise finance to fund the infrastructure. This funding and financing approach allows the Project to be 'ring-fenced' from the individual local authority's borrowings.
- **Vesting** (asset transfer): the infrastructure funded by the Levy will be owned by the SPV during the construction (in most cases), and on its completion will (in most cases) be transferred to the relevant council or public body.
- **Collaborative process**: the individual local authority or local authorities will be involved throughout the Model process, with final Levy approval resting with the Crown, through an Order in Council which specifies the Levy.
- **Works in conjunction with local authority processes**: the Model does not change local authorities' normal financial (borrowing) approach or planning and consenting approvals. It is expected that the Model will support existing infrastructure strategies.
- **Government Support**: under the Model, the Crown will take on some limited risks such as force majeure.

The proposed process to take a project from conception through to being funded by a Levy and then transferred back to a public entity (if not already in public ownership) is complex and there are several sub options considered in the design of this process by the Department and the Treasury. In doing so we identified the policy issues (bottom row of the following diagram) and have addressed these in detail in the appended Treasury Report.

Process for setting a Levy:



The Model represents a significant shift from the status quo, however, the use of the Model will enable infrastructure projects to proceed that under the status quo might simply never get done or will stay within the current timing and sequencing as provided for in local authorities' long-term plans.

The Model will require greater transparency and rigour in the allocation of risk and costs to the appropriate parties. The use of the Model means that the viability of the project becomes the key decision, removing the trade-offs which local authorities often make when allocating capital.

3. Optimising the existing local government toolkit

As described in section 2.2, local authorities have access to a range of powers that enable them to raise revenues through general rates, targeted rates, development contributions, user charges and other mechanisms. The existing local authority funding toolkit is generally considered to be fit for purpose with some adjustments needed. However, it is not used optimally, and practices vary across local authorities. Local authorities may also be constrained by existing legislation in recovering the full cost of local infrastructure for new development and take on some development or infrastructure uptake risk.

Optimising and expanding the existing local authority funding and financing toolkit offers several potential benefits. For example, the targeted rates and development contributions framework could be amended to enable these mechanisms to be used to shift costs and risk to more appropriate parties and timeframes, allowing local authorities to recover the full cost of local infrastructure.

A further option could be to enable the striking of multi-year targeted rates by local authorities. This may provide for increased revenue and longer-term revenue certainty such that local authorities could raise additional finance, over and above what they can today.

Optimising the existing toolkit could help shift development risk from councils and provide for a more efficient and equitable distribution of costs of infrastructure provision. However, some councils may still be debt constrained and does not diversify the funding and financing options available so is a partial solution only.

A comprehensive review of the existing tools will be a complex and long policy process followed by the need for legislation. This option should be explored further to understand the how optimisation of the existing toolkit can support the timelier provision of infrastructure for housing and support urban development. This forms the third workstream of the IFF work programme.

The Productivity Commission's Local Government Funding and Financing Inquiry looks to comprehensively assess how these tools could be optimised. The Department will be responsible for the government's response to the inquiry.

3.2 What criteria, in addition to monetary costs and benefits, have been used to assess the likely impacts of the options under consideration?

The Department considered the following criteria:

Efficiency

Local infrastructure provision for urban development in high growth areas is typically lacking. There is a need to promote the acceleration of bulk infrastructure provision, such that housing supply can match demand.

Preferred mechanisms will increase incentives, or mitigate disincentives, to infrastructure investment that is net beneficial to a community.

Higher levels of efficiency imply those residents that benefit from the local infrastructure are required to contribute to its costs; that residents who have led to or been responsible for the additional requirements contribute to the cost of the local infrastructure. This is to say that the burden of growth on society is minimised.

Equity

Higher levels of equity imply improved housing outcomes and that the associated costs on households are commensurate with the ability to pay. There are likely to be some trade-offs between equity and efficiency at a project level when determining beneficiaries and allocation of a levy/charge.

Effective 'ring-fencing' from Council balance sheet

A negative impact on a local authority's balance sheet will have implications for their debt covenants and may result in a credit rating downgrade, likely leading to higher borrowing costs. Any solution that has a negative impact on a local authority's balance sheet will have limited applicability as it will be unlikely to be used by local authorities. Some local authorities are debt constrained, so any tool that overcomes this constraint will be more favourable.

Replicability and scale of opportunity

New mechanisms will need to be replicable across local infrastructure investments and local authorities.

Different financing and funding mechanisms will provide councils with varying levels of access to financial capital. Preferred financing mechanisms will alleviate the technical constraints to financing local infrastructure and enable councils to provide net beneficial infrastructure.

Any new tool will demonstrate that different methods of finance can be made workable (as a first step in the evolution of the local authority funding and financing system). This also helps to diversify local authority approaches to borrowing.

Secure long-term revenue stream

Long-term debt capital requires secure long-term revenues. Any risk to the security or tenure of the revenue stream will likely result in a significant risk premium being applied and lead to a higher cost of capital. In some circumstances, this premium may mean that it is not viable to finance a project via a financing mechanism.

Speed of implementation

Some high-growth councils are reaching their debt ceilings. Any new mechanism will need to be able to be implemented in a relatively short time horizon (within 12-18 months). Ministers have also indicated that any new mechanisms should be able to be used by 2020. Ideally, local authorities will be able to utilise a new tool to support their 2021-2031 long-term plans.

Speed of implementation should not be prioritised ahead of an enduring solution. Any legislative or behavioural changes will take some time.

Credit rating agency assessment

A critical element of any new alternative financing option is that there is no adverse impact on councils' balance sheets, debt covenants or credit rating agency assessment. Guidance from credit ratings agencies in regard to these considerations has limited the feasible options available for consideration.

3.3 What other options have been ruled out of scope, or not considered, and why?

Ministers have ruled out further direct funding support from the Crown at this time.

Section 4: Impact Analysis

Key:

++	much better than doing nothing/the status quo	+	better than doing nothing/the status quo
-	worse than doing nothing/the status quo	- -	much worse than doing nothing/the status quo
0	about the same as doing nothing/the status quo		

	No action	Expanding local authority debt capacity	Alternative financing (legislative charge model)	Optimising existing local authority toolkit
Ring-fenced from Council balance sheet	0	0	++	0
Secure long-term revenue stream	0	0	+	+
Efficiency	0	0	++	++
Equity	0	0	++	++
Scalable and replicable	0	+	++	+
Speed of implementation	N/A	2 years	1 year	2 years
Overall assessment	0	+ Extending debt capacity is not a 'quick-fix' as it only extends the debt boundary. This delays the problem rather than providing an enduring solution. Biases against increasing local authority debt remain. May also result in a credit rating downgrade. Minor improvement.	++ Alternative financing expands the local authority funding and financing toolkit and diversifies borrowing approaches. This approach also realigns development costs and risks to more appropriate parties than the status quo approach.	+ Optimising the existing toolkit could help shift development risk from councils and provide for a more efficient and equitable distribution of costs of infrastructure provision. However, some councils may still be debt constrained so is a partial solution only. A comprehensive review of the existing tools will be a complex and long policy process followed by the need for legislation.

	No action	Expanding local authority debt capacity	Alternative Financing (legislative charge)	Extend use of existing local authority toolkit
Ring-fenced from Council balance sheet	Local authorities currently finance local infrastructure using their balance sheet. Typically, debt is guaranteed against a local authority's general revenues.	This will provide a one-off increase in borrowing capacity for local authorities. Increasing the amount of debt local authorities take on will have a corresponding impact on their balance sheet. This approach risks a credit rating downgrade, which may increase the cost of borrowing. Due to the way local authorities borrow (via the LGFA), this is likely to impact all councils, regardless of whether a council borrows more.	This option ensures that the debt associated with a SPV is ring-fenced from Council's balance sheet. Equity or any Council contribution will impact on the Council's balance sheet.	No change from the status quo.
Secure long-term revenue stream	Local authorities currently strike rates annually. This means that homeowners do not have certainty as to what their rates could be in future.	No change from the status quo approach.	A long-term revenue stream would be enabled by legislation for a period of up to 50 years. Note that this is in addition to existing local authority rates.	Optimisation or enhancement of targeted rates could improve long term revenue security.
Efficiency	The cost of infrastructure is not well understood and rarely fully recovered through existing mechanisms.	No change to the status quo toolkit. Anticipate local authorities would continue to use the general rating base to fund projects.	Pricing of local infrastructure is clearly signalled and fully cost recovered. This is an improvement on the status quo.	Depending on the extent of the changes resulting from this option, the pricing of local infrastructure could more accurately reflect the cost, enabling a more efficient allocation of resources.
Equity	The mix of funding tools available to local authorities	No change to the status quo toolkit.	Equity and affordability considerations are fundamental	Optimisation or enhancement of targeted rates could improve

	enables them to consider the extent to which costs are recovered from general ratepayers or directly from users/exacerbator.	Anticipate local authorities would continue to use the general rating base to fund projects.	to the Levy design criteria, as an SPV will have a legislative ability to collect the Levy. The design of any Levy will need to be transparent as to who is paying for what and why.	equity.
Scalable and replicable	All local authorities have similar rating and taxing powers.	No change from the status quo.	Alternative financing is only viable where a project (or bundle) requires over $50 million of financing. This is due to the transaction costs associated with establishing a SPV. The model is replicable across local authorities where this threshold can be met. Some smaller local authorities may struggle to meet this threshold but bundling of projects should assist.	Optimisation or enhancement of targeted rates is replicable across local authorities. The uptake however could be variable as local authorities existing policies have grown up over time within their specific context and may be difficult to change.
Speed of implementation	Local authorities plan local infrastructure over 1, 10 and 30 years horizons (respectively these are generally, annual plan, long-term plans and infrastructure strategies).	Estimate that amending LGFA debt covenants would take approximately two years to undertake. Extensive consultation with LGFA shareholders would be required. Including consideration of other means to sovereign credit rating for the LGFA.	Legislative change would be required. This is feasible in 2019, which would align with local authorities' long-term planning processes. This is subject to available House sitting time and the legislative agenda.	As with alternative financing, this requires legislative change of following a substantive and complex policy process that would impact and need to involve all local authorities.
Accelerates provision of infrastructure	N/A	The pace at which local infrastructure could be provisioned has scope to be enhanced under this approach.	Alternative financing removes the technical infrastructure financing constraint and re-aligns incentives to provide	Would provide further funding (and therefore financing) capacity. The pace at which local infrastructure could be

		Other constraints, such as political economy and market constraints that may still hinder the level of acceleration. These will need to be considered and mitigated where possible.	local infrastructure and support the development of housing. Local infrastructure investments could be brought forward within a long-term plan period (10 years), or a previously unconsidered investment could be enabled.	provisioned has scope to be enhanced under this approach. Other constraints, such as political economy and market constraints that may still hinder the level of acceleration. These will need to be considered and mitigated where possible.
Overall assessment	Where local authorities are not facing growth or declining pressures the status quo functions well.	Initial indications from some local authorities and LGFA is that a Crown guarantee of LGFA's debt and a capital injection into the LGFA to support the additional borrowings would be required. This provides further borrowing capacity. However, it only delays the problem as the increased headroom will likely be utilised in a short period. It does not support wider IFF or UGA objectives to improve land supply and housing affordability.	Alternative financing meets the objectives of the IFF work programme. It provides a mechanism that ensures beneficiaries pay, and that costs and risks are more transparently allocated than alternate options. This option achieves all the IFF objectives and meets the criteria set out in section 3.2.	It is difficult to judge the extent to which more widespread use of existing tools, such as targeted rates, would be feasible or deliver a meaningful and sustained step-change in the level of local infrastructure provision to support housing. Optimisation and enhancement of these tools provides the ability to increase local infrastructure provision and improve land supply dynamics. These tools only directly address funding. If there was a significant change in funding available via this option, then additional financing could be available under existing financing arrangements.

Section 5: Conclusions

5.1 What option, or combination of options, is likely best to address the problem, meet the policy objectives and deliver the highest net benefits?

Preferred option: Prioritise alternative financing (legislative charge model)

Following consideration of the options against criteria in section 3.2, trade-offs discussed in section 3.1, and consultation with Ministers, local authorities and other stakeholders, alternative financing is the preferred option to progress in the first instance. Alternative financing on its own will not solve the suite of challenges inhibiting responsive local infrastructure provision, competitive land markets and housing affordability generally. However, it helps to address the financing constraint that is causing local infrastructure provision to lag and help ensure that net beneficial projects proceed. It also helps to shift development risk away from local authorities and move toward a more equitable approach to paying for growth infrastructure. An examination of the options will also support improvements. The remaining pillars of the UGA will be a crucial supporting work programme.

The Model helps address the financing constraint that local authorities face by allowing a much greater quantity of debt to be leveraged from revenue streams than possible under current arrangements. By removing the financing constraint, it also minimises the number of trade-offs local authorities make when allocating scarce capital which will assist local authorities to better manage their financing burden and support the timely provision of local infrastructure.

It is an equitable financing tool that provides greater rigour to the allocation of risks and cost to appropriate parties and allows viable projects to proceed outside of the current local authority financing framework, better aligning development to anticipated urban demand.

It will be accessible for any viable project that meets certain legislative and policy criteria (these will be set out in relevant Cabinet papers), which provides the ability for it to be scalable and replicable across local authorities. It is important to note that the Crown, through an Order in Council, will determine whether a project proceeds under the Model (please refer to section 6.1 and the appended Treasury Report for more detail on how the process will work).

The Model demonstrates that alternative financing mechanisms are possible, providing local authorities with more choice about how they fund and finance growth. Alternative financing is not the only solution. We also recommend examining, at a future point, optimising the existing suite of local government funding and financing tools to complement the Model and support a longer-term evolution of local authority financing approaches.

Primarily, the legislation is needed to allow new entities (SPVs[14]) the ability to collect a levy (akin to a targeted rate) that can be set for a long period of time (up to 50 years) to provide the long-term revenue stream for financiers. This legislative change will mark a significant change to the status quo in two key respects:

- First, it will enable new entities to have statutory charging powers akin to targeted

[14] Note, the legal form of SPVs is not specified, as this could take a number of forms. The form and governance of these entities may be Project specific.

rates. Anything less than the new entity having the power to charge directly (such as a local authority transferring or assigning their powers) will not alleviate the financial restrictions faced by local authorities (i.e. the debt will still be included in the local authorities' debt to revenue ratio and thus be an ineffectual tool).

- Secondly, it will enable the Levies to be set for a long period of time (up to 50 years). Under existing legislation, a local authority may only set a rate for one financial year only (in accordance with their annual or long-term plan for that year). The current inability of local authorities to pre-emptively set rates for an extended period is a barrier to the financing of local infrastructure projects by a third party who requires certainty of revenue.

Making such Levies available to third parties is a significant but necessary shift to enable the Model.

As evident in the impact analysis tables (refer section 4), the alterative options have merit. It is proposed that work on these options be progressed as resources allow. These alternatives form workstreams two and three as described in section 1.2.

The wider UGA will also be an important work programme to support the Model and create a more efficient urban planning system in New Zealand.

5.2 Summary table of costs and benefits of the preferred approach

Affected parties *(identify)*	**Comment**: *nature of cost or benefit (eg ongoing, one-off), evidence and assumption (eg compliance rates), risks*	**Impact** *$m present value, for monetised impacts; high, medium or low for non-monetised impacts*	**Evidence certainty** *(High, medium or low)*
Additional costs of proposed approach, compared to taking no action			
SPVs	Ongoing disclosure, audit and compliance costs for SPVs.	Estimated at $200,000 per annum, per SPV	Medium
Facilitator and Monitor	One-off establishment costs of a crown facilitator and monitor.	Unknown (an existing entity could undertake this function)	Low
	Development of guidance and policy (one-off)	$2,000,000 (one-off)	Low
	Ongoing operating costs of a crown monitor	Unknown(an existing entity could undertake this function)	Low

Levied consumer	Ongoing Levy associated with property purchased.	Variable – will be project specific. *By way of example, under Milldale CIP project, the Levy per property is $1,000 per annum, escalating at 2% per annum for 30 years.*	High
Total Monetised Cost		Unknown	
Non-monetised costs		*(High, medium or low)*	

Expected benefits of proposed approach, compared to taking no action			
Potential homeowners	With more land serviced for housing development, potential homeowners should enjoy the benefit of increased housing choice.	Medium	Low
Local authorities	Local authorities will be able to overcome their debt constraints to support housing related local infrastructure. This will allow them to make different choices about how they allocate their scare capital.	Unknown	Low
Wider government	Under this approach, the government is less likely to need to intervene directly in local infrastructure provision, or to provide financial support to local authorities for housing related local infrastructure.	Medium	Low
Total Monetised Benefit		Unknown	
Non-monetised benefits		Medium	

5.3 What other impacts is this approach likely to have?

To the extent the Model is successful in supporting the UGA to improve housing affordability and broader housing outcomes, individuals will have great choice about where they live, work and play.

These broader benefits of the Model are difficult to attribute to specific population groups. For example, there is some uncertainty as to the broader distribution of the costs and benefits of the Model. It is possible that the model favours greenfield developments that are then more attractive to first home buyers, because of the lower upfront costs. This is because the cost of the local infrastructure related to the house is spread out across a 30-year period.

Because the Model removes the local infrastructure financing constraint, it is conceivable that urban centres may grow in area size faster than anticipated, or desired. This should be able to be managed through the RMA planning processes.

5.4 Is the preferred option compatible with the Government's 'Expectations for the design of regulatory systems'?

The proposed approach (the legislative charge model) meets the expectations.

Section 6: Implementation and operation

6.1 How will the new arrangements work in practice?

The Minister for Housing and Urban Development has indicated that any new financing mechanism should be in place by the end of 2019. This will enable local authorities to utilise the tool in the development of their 2021 long-term plans. For the proposed Model to be implemented, enabling legislation is required.

The legislation design will contemplate Levy design criteria, including an appropriate monitoring and enforcement regime. An offence regime will also need to be developed to support the Monitor to undertake its activities. The overall end-to-end process is illustrated below. A crucial element to draw attention to is the mechanism by which a Levy is set. Under the proposed approach, a Levy will be set through an Order in Council. The Order in Council will stipulate who can be levied and the maximum levy income an SPV can receive.

Each Project will pass through the following include the following roles and processes[15]:

- **Proposer**: Projects can be proposed for the Model by local authorities', developers, the Crown or any other person
- **Facilitator & Recommender:** The Crown will establish a Facilitator to work with Proposers and local authorities to assess the viability of a project and design a funding and Levy proposal
- **Approver:** Approvals (for the Levy and underlying project) are a collaborative process between local authorities and the Crown. The Approver entity has not yet been defined, but it likely to be a central government agency, such as the Treasury or Ministry of Housing and Urban Development.

  An Approver will need to be satisfied that a project and the Levy are appropriate, and that the local authority can manage the network and financial implications of the Project post-completion.
- **SPV:** the SPV will be responsible for raising the finance for a project and managing construction. It will use the Levy to raise finance to fund infrastructure
- **Monitor**: a Crown monitor will ensure that the SPV is operating pursuant to the parameters set by the Order in Council. The Monitor will be responsible for monitoring, reviewing and reporting on the SPVs activities.
- **Asset Transfer:** on completion the infrastructure assets will be transferred to the relevant council or CCO.

[15] This process is detailed further in the appended Treasury Report.

6.2 What are the implementation risks?

Throughout the development of this RIA, the Department and the Treasury have been working closely with a number of officers from several local authorities. Throughout this process, a number of implementation considerations have been raised and worked through.

There are also several second order risks described below. These are risks that may influence the extent to which and how the Model is used.

Key implementation considerations:

- Interaction between developer contributions and the Model
- SPV powers
- SPV ownership and governance structure
- Levy design criteria / beneficiary identification
- Local Authority approval mechanisms
- Capacity of construction market to deliver more infrastructure
- Alignment of other government infrastructure policies and investment mechanisms

Interaction between developer contributions and the Model

It is possible that a local authority may have already begun collecting development contributions under the Local Government Act 2002 for a particular project. To facilitate the application by a local authority of existing development contributions to projects that the local authority is no longer procuring itself, it is proposed that the legislation will facilitate the transfer of existing development contributions to the SPV (or otherwise applied to the relevant Project).

To prevent double charging, previously paid development contributions may be a factor in the design of the Levy. In addition, once the charge has commenced, development contributions will not be permitted for the project infrastructure. This will not preclude developers making voluntary capital contributions to expedite their ability to proceed with subdivision or development in a wider project area.

SPV Powers

SPVs that are responsible for the construction of assets may need to have power to carry out some of its functions, including:

- requiring authority status under the Resource Management Act 1991;
- power to construct and maintain works on private land;
- associated powers of entry onto private land; and
- power to construct works and roads on public land.

Although these powers may appear extensive, it is important to note that the SPV would only be able to exercise these powers for its very specific purpose (i.e. the construction of specified infrastructure assets) which reduces the risk of abuse. The Treasury and the Department are working with relevant government agencies to assess the options to provide SPVs with access to these powers, where appropriate and with safeguards.

SPV ownership and governance structure

SPV ownership and governance structures will play an important role in determining the sustainability of the Model. Who controls the SPV will be a critical test that rating agencies will have regard to when determining the Crown's or a local authority's credit rating. Currently, the Department and the Treasury are working with high-growth local authorities to develop appropriate ownership and governance structures that meet IFF objectives, rating agency considerations and provide an appropriate level of consumer protection and public scrutiny.

Levy design criteria and beneficiary identification

Equity and affordability considerations are fundamental to the Levy design criteria, as an SPV will have a legislative ability to collect the Levy. The design of any Levy will need to be transparent as to who is paying for what and why. The rating principles found in section 101(3) of the LGA are a good platform to base the Model Levy design criteria on as they balance equity and affordability. The Department and the Treasury are of the view that the criteria below, modelled on the LGA, will provide for transparency and ensure equitable allocation of project costs to beneficiaries:

- the distribution of benefits between the project community (as a whole), identifiable parts of the project community, and individuals;
- the period in or over which those benefits are expected to occur;
- the extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake a project;
- an assessment of affordability and sustainability over the intended period of any Levy;
- any other matters of practicality, efficiency or equity relevant to the IFF regime; and
- the extent of benefits outside the project community (if any).

Broadly these criteria will identify who benefits from a project, when they benefit (intergenerational equity), and who causes the need for the investment (exacerbator pays). These criteria may be modified during the detailed policy and legislative design process.

Nevertheless, the accurate and fair identification and subsequent allocation of costs in brownfield and greenfield areas (Levy design) may be difficult, particularly where a project has network impacts or where there are existing residents (and second wave beneficiaries). For example, current methods of recovering costs such as development contributions, consistently under recover actual cost. This is unlikely to be completely resolved under alternative financing models. Improvements in this area will be required for all parts of the system (not just the IFF). The UGA *Urban Planning* pillar will assist in this.

As part of the UGA's *Urban Planning* pillar, the Ministry for the Environment is undertaking work on the costs and benefits of urban development. To date, this work is a conceptual approach to measuring urban development costs and benefits. It is looking to identify the specific costs/benefits and find evidence of how to measure and value each cost/benefit. Of the 27 categories of costs/benefits identified so far, there is good evidence for measuring three. While this work may help to inform allocation of project costs to beneficiaries in the early stages of the Model's implementation, in the longer term it will play a bigger role informing policy settings to SPVs.

Local authority approval mechanisms

The Model removes the financing constraint on local infrastructure projects for local government. The trade-off to achieve this requires conferring a 'tax' power to a new entity – SPV – (which may be privately held) through central government approval of the form of an Order in Council.

At a conceptual level, the Model has two sets of approvals embedded. The first is the approval of the *Project*, while the second is the approval of the *Levy*. There may be a third approval in some instances where other support may be required, such as a contribution from the New Zealand Land Transport Agency.

Projects themselves may require multiple forms of approval, such as resource consents or plan changes. These approvals will be managed through the usual planning and consenting policies of local authorities. The type of local infrastructure anticipated to be funded through the Model would typically have been funded and financed by a local authority. Under the Model, the local infrastructure asset will vest to the local authority on transfer once the construction of the infrastructure is complete. Vesting may create ongoing financial obligations on local authorities in respect of operating and maintenance costs. Consequently, local authorities will have a mechanism that allows them to assess the network and financial implications of the project. While this approval mechanism is still under development, approval is expected to be sought at the 'Approver' stage of the process, with in-principle approval being sought earlier in the process at the 'Facilitator' stage.

Approval of the Levy is separate to the project itself and will be granted by the government through an Order in Council (a legislative instrument). The Order in Council will only be sought after a Project has passed several gateways throughout the end-to-end process, including acceptance of the project's financial and network implications by the relevant local authority. These mechanisms, particularly the Order in Council, helps to ensure democratic accountability in relation to the Levy and to a lesser degree, the project.

Alignment of other government infrastructure policies and investment mechanisms

The government influences infrastructure investment at the local level through a number of vehicles, such as the Government Policy Statement on Land Transport (**GPS**), administered by the New Zealand Transport Agency (**NZTA**), or the soon to be established Infrastructure Body. There is a risk that projects that proceed under the Model are inconsistent with these vehicles.

For example, the GPS signals the direction of government investment in transport infrastructure at the local and national level. It is possible that some projects may not align with these priorities, meaning that co-funding may not be available. Where this occurs, the cost will need to be borne by project beneficiaries. This may impact the overall feasibility of a project. Proposers will therefore be incentivised to align projects, insofar as practicable with the GPS and engage with the NZTA.

Construction market constraints

Consultation with local authorities has indicated that there may be some difficulties in increasing local infrastructure and housing investment due to capacity constraints in the construction sector. There are some mitigating factors, such as the horizontal

Christchurch rebuild concluding, that may mean more capacity is available. However, other constraints, such as a lack of housing for contractors, may continue to put pressure on the construction sector. This risk cannot be mitigated through the IFF work programme.

Second order risks:

Unwilling beneficiaries

Unwilling beneficiaries could be levied under the Model. Mitigation of this risk is challenging as there are many variables that lead to a beneficiary being unwilling. Beneficiary identification, allocation of costs, equity and affordability will be key considerations in the Levy design process which will help mitigate this risk. In a greenfield development situation this risk is more remote as purchasers and developers will be fully aware of the Levy. This risk is less remote in instances where brownfield development is funded and financed via the Model due to the impost of the Levy.

Development incentives

Development may be incentivised away from brownfields as the Model will be more easily applied to greenfield projects (due to the greater simplicity of identifying beneficiaries and those who opt-in). This may have environmental impacts and also work against wider urban development objectives. This risk will be partially mitigated through implementation of the wider UGA work programme.

The Model may encourage development that is not aligned with central or local infrastructure planning and/or sequencing. This could potentially lead to poor urban development outcomes (such as lack of connectivity, accessibility and inefficiency of network investment). This will be mitigated by improving spatial planning practice and central local government partnerships through the UGA.

Incentives for local authorities

There is a risk that new SPVs are used by local government to substitute for projects traditionally funded through general rates (thus keeping rates artificially low), rather than increase their overall spend on infrastructure. Consultation with local government officials has not indicated this is the intent. The Facilitator and Approver functions in the process will help manage this risk.

Ultimately a project and Levy can only proceed following Cabinet approval and Order in Council, which will further mitigate this risk.

Affordability and acceptability of the Levy

There is a risk that the Levy is unaffordable either in the context of total rates and Levies, or on an individual basis. If the Levy is not affordable it may lead to non-payment by beneficiaries and pose a risk to the project more generally. This risk is being addressed through the disclosure regime and by affordability being one of the considerations for both local authorities and central government when approving the use of the Levy.

Sufficient Project scale

Scale of a project will be a key determinant of whether a project proceeds under the Model or through another mechanism. It is anticipated that for a project to be viable under the Model, the capital works programme will need to be a minimum of $50 million and be deliverable within 5-8 years. For example, a Project that has a capital works period of 30 years would not be viably financed under the Model. There is a risk that local authorities outside of the high growth councils, will not have projects of sufficient scale. Project bundling will partly mitigate this risk. We are also working with selected local authorities to identify candidate projects for the Model.

Underutilisation of the Model

Legislation and processes supporting the Model will need to be simple and accessible to potential project proposers to mitigate this risk. Throughout the legislative and policy development process officials will work with local authorities and elected representatives to ensure that the tool is fit for purpose for local authorities. Other factors such as labour market and material constraints may mean the use of the tool is not as widespread as desired. These factors cannot be fully mitigated through the design of the Model but will be considered as part of the UGA.

Ability for the Levy to cover the full cost of the Infrastructure

In some cases, it may be unaffordable for beneficiaries to cover the full cost of the infrastructure via the Levy. In this case a contribution from the local authority or other related party (e.g. NZTA) might be required to provide complete funding. In some cases, a contribution from the local authority may mean the debt of the SPV is included with the rating agency assessment of the local authorities financing constraints. In these situations, the merits of using a Levy will need to be considered on a case-by-case basis.

Communication with local authorities and beneficiaries

The Levy and use of an SPV could be misinterpreted by the public, beneficiaries, local authorities or the media. Unfavourable public commentary on the Levy could lead to non-payment. To manage this risk Treasury will prepare a communications plan for any announcements about the introduction of legislation and will work with your offices to arrange briefings of key stakeholders in advance of any announcements.

Additionally, the complexity of the Model may undermine uptake from developers and local government, and requires sophisticated understanding from political decision makers, officials, developers and consumers. Transparent and clear supporting material will be developed to avoid misconceptions and assumptions and increase the likelihood of uptake.

Section 7: Monitoring, evaluation and review

7.1 How will the impact of the new arrangements be monitored?

At a high-level there are two parts to monitoring the Model:

1. whether the benefits are being realised (the extent to which the Model is used for its purpose); and

2. monitoring of individual projects facilitated by the Model.

Benefit realisation

To support projects through the IFF Model and provide oversight, it is proposed that a Crown IFF Facilitator is established. The Facilitator will be responsible for assessing the feasibility of proposals working with a project proposer to develop funding proposals for feasible projects. These critical gateways will ensure that beneficial Projects proceed under the Model.

The extent to which benefits are realised will depend on how widely the Model is used. The volume and yield of projects that proceed under the model will provide a clear indication as to the effectiveness of the Model. Future NPS-UDC HBAs will also provide a good proxy for assessing the level of infrastructure provision, and local authorities' ability to meet current and future community needs.

Officers of local authorities have been engaged in the development of the proposed approach and are supportive. Officers consider that there a number of applications for the Model to support greenfield and brownfield developments earlier than otherwise possible.

Project / SPV Monitoring / Reporting / Intervention

The monitoring and intervention regime for the Model is under development but will be designed to protect against an abuse of the delegated charging right and misappropriation of funds. It will manage construction risks associated with a project.

As the levy power for the Levy is being provided to a SPV, a robust reporting monitoring and intervention regime is essential to ensure appropriate transparent and oversight. The table below sets out the proposed regime:

Monitoring	Reporting	Intervention
Crown-appointed Monitor for each SPV. Monitor to approve application of Order in Council by SPV (e.g. approval of annual Levy calculations). Monitor to receive periodic reporting from the SPV in respect of the Levy and the project.	SPV required to release its audited Annual report. No Official Information Act requirements (unless they already exist (i.e. if SPV is Crown/local authority)) as the Monitor will most likely be subject to the OIA.	Power for the Monitor to direct the SPV to address significant problems with the Levy. Power for the Crown to exercise SPV's rights if the SPV has not complied with the Monitor's previous direction to address significant problems with the calculation of the Levy.

Monitor to receive reporting from the SPV on material events and to be able to require information from the SPV. Monitor to receive and action any complaints.		

It is anticipated that a Crown body will be nominated to monitor SPVs established under the Model. This is likely to be a central government agency (such as the Treasury, or the Ministry of Housing and Urban Development).

SPV Reporting

The public will have a genuine interest in the activities of an SPV that is operating with the use of public funds and is responsible for the delivery of public infrastructure. It is expected that SPVs will be required to publish an annual report audited by the Auditor-General. Requiring an SPV, which may be privately-owned, to be audited by the Auditor-General should demonstrate some public oversight and therefore assist with community acceptance of the IFF regime.

Intervention regime

Notwithstanding the existence of a monitoring regime, and the requirement for SPVs to publish annual reports and be subject to audit by the Auditor-General, it remains possible that an SPV could misuse its special powers to charge beneficiaries. In such a circumstance, intervention may be warranted. The Treasury and the Department are developing options for an intervention regime to ensure beneficiaries are protected.

7.2 When and how will the new arrangements be reviewed?

As the Model will take a number of years to mature, a future review of the Model has not been explicitly considered by the Department or the Treasury. Ongoing monitoring through a monitoring regime and the Crown's Facilitator and Approver functions will provide a stream of advice to Ministers as to how well the Model is working to advance housing objectives.

The Model is the next stage in the evolution of the HIF and CIP models. The HIF and CIP models took several years to develop and take to the Market. Developers, local authorities and financiers are becoming familiar with these models, in particularly the contractual CIP model.

Nevertheless, local authorities, developers, financiers and home owners will need time to become familiar with the legislative Model and the processes involved. The Department estimates that the model will take at least one long-term plan cycle to mature. The next set of local authority long-term plans is due in 2021.

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Appendix Two – Treasury Report T2019/72, Infrastructure Funding and Finance – Infrastructure Levy Model

Overleaf

The Treasury

Infrastructure Funding and Finance Information Release

November 2019

This document has been proactively released by the Treasury on the Treasury website at

https://treasury.govt.nz/publications/information-release/infrastructure-funding-finance

Information Withheld

Some parts of this information release would not be appropriate to release and, if requested, would be withheld under the Official Information Act 1982 (the Act).

Where this is the case, the relevant sections of the Act that would apply have been identified.

Where information has been withheld, no public interest has been identified that would outweigh the reasons for withholding it.

Key to sections of the Act under which information has been withheld:

[33] 9(2)(f)(iv) - to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials

[34] 9(2)(g)(i) - to maintain the effective conduct of public affairs through the free and frank expression of opinions

[37] 9(2)(i) - to enable the Crown to carry out commercial activities without disadvantage or prejudice

[38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice

[39] 9(2)(k) - to prevent the disclosure of official information for improper gain or improper advantage

Where information has been withheld, a numbered reference to the applicable section of the Act has been made, as listed above. For example, a [23] appearing where information has been withheld in a release document refers to section 9(2)(a).

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TE TAI ŌHANGA
THE TREASURY

Treasury Report: Infrastructure Funding and Finance – Infrastructure Levy Model

Date:	8 April 2019	**Report No:**	T2019/72
		File Number:	SH-3-2-18-16-1-1

Action Sought

	Action Sought	Deadline
Minister of Finance (Hon Grant Robertson)	**Agree** the contents of this report	29 April 2019
Minister of Housing and Urban Development (Hon Phil Twyford)	**Agree** the recommendations of this report	15 April 2019
Minister for the Environment (Hon David Parker)	**Agree** the contents of this report	15 April 2019
Minister for Local Government (Hon Nanaia Mahuta)	**Agree** the contents of this report	15 April 2019
Minister for Infrastructure (Hon Shane Jones)	**Agree** the contents of this report	15 April 2019
Associate Minister of Transport (Hon Julie Anne Genter)	**Agree** the contents of this report	15 April 2019

Contact for Telephone Discussion (if required)

Name	Position	Telephone		1st Contact
Emma White	Senior Analyst	[39]	[39]	✓
Stacey Wymer	Director	[39]	[39]	

Actions for the Minister's Office Staff (if required)

Return the signed report to Treasury. **Forward** a copy of this report to the Minister of Commerce and Consumer Affairs.

Note any feedback on the quality of the report

Enclosure: No

Treasury Report: Infrastructure Funding and Finance: Infrastructure Levy Model

Executive Summary

Introduction

1. In September 2018 the Cabinet Economic Development Committee (DEV) directed Treasury and the Department of Internal Affairs (DIA) to report back on alternative financing models to fund local infrastructure, and any associated legislation that would be required to underpin these models.

2. The use of alternative financing models is being explored because most high growth councils[1] are close to their maximum debt levels (with debt at 250% of revenue), which constrains their ability to borrow to deliver infrastructure. Without appropriate financing and funding tools, infrastructure supply cannot meet demand. Infrastructure is a necessary enabler for development and most bulk infrastructure is provided by local authorities.

3. The goal of alternative financing models is to free infrastructure investment from local authority financial constraints.

4. The treatment of the alternative financing model by credit rating agencies is critical; if the rating agencies' view any debt raised through an alternative financing model as being an obligation of local authorities, the goal will not be achieved. The credit rating agencies' require there is no legal or moral recourse to the local authority should the alternative financing model fail. This means that no liability (actual or contingent) under the alternative financing model can sit with the local authority and an entity independent of the local authority must have the power to levy directly.

Infrastructure Levy Model

5. This report outlines the proposal to establish an alternative financing model referred to as the Infrastructure Levy Model (the "Model"). The Model is designed to enable new infrastructure projects and upgrades to existing infrastructure to be delivered without being limited by local authority financial constraints.

6. The core of the Model involves the setting of a multi-year Levy (the "Levy") which is paid by beneficiaries of infrastructure projects. The Levy is enabled by legislation and levied by a Special Purpose Vehicle (SPV) which is responsible for financing all or part of the infrastructure project, and has the power to collect the Levy. The SPV may also itself (but doesn't always need to) have a direct role in commissioning construction of the infrastructure. The infrastructure will be transferred to the local authority post construction for nil consideration.

7. A fundamental element of the Model is the provision of a Government Support Package (GSP) to cover certain contingent residual risks. These are the contingent residual risks that would normally sit with the local authority [38]
[38]
The GSP is critical to ensuring that there is no recourse back to the local authority and therefore meeting rating agency requirements.

[1] High growth councils include Auckland, Hamilton, Tauranga and Queenstown.

8. This Model is intended to complement, rather than replace, local government infrastructure provision. The Model represents an evolution of the alternative financing model developed by Crown Infrastructure Partners (CIP).

9. While the Model is targeted to the provision of local government infrastructure, it also provides a tool that can be used to support the funding of central government infrastructure initiatives.

Why is legislation required?

10. Legislation is required to enable the Model. Primarily, the legislation is needed to allow an SPV to collect the Levy (akin to a targeted rate) that can be set for a long period of time (up to 50 years). The ability for an entity independent of local authorities to collect the Levy (that in turn is used to fund the construction of infrastructure) is fundamental to ensure the delivery of infrastructure is not limited by the financing constraints of local authorities.

11. Legislation is also needed to provide the SPV with certain powers during the construction of the infrastructure.

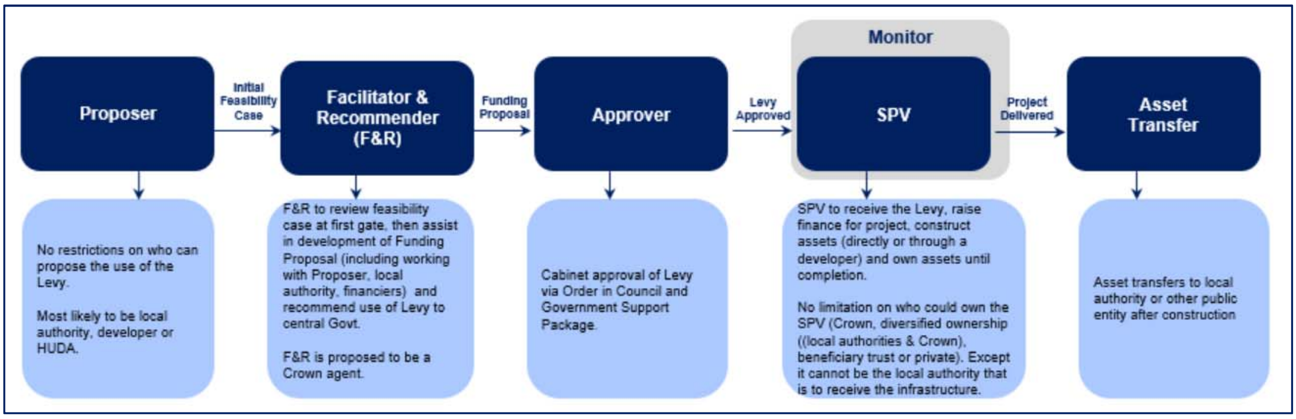
12. The legislation is proposed to be enabling and permissive rather than prescriptive. This reflects that the legislation will need to cover a range of scenarios and infrastructure types and to allow the Model to evolve over time. Given the permissive nature of the legislation, more detailed guidance will need to be developed to cover matters such as how beneficiaries might be identified and how the Levy might be allocated among beneficiaries.

How the process will work

13. The process requires the Levy for each infrastructure project to be approved by the Crown through an Order in Council (OIC). The OIC will set out the details of the Levy including the amount that can be recovered, the term of the Levy (up to 50 years), the beneficiaries of the project who will be subject to the Levy, and the basis of allocating the total Levy between the beneficiaries.

14. The diagram below outlines the process for how an infrastructure project might be identified and a Levy raised.

Process for setting a Levy



Key considerations

15. The Model represents a significant change to the status quo. To accelerate infrastructure delivery, the Model will require greater Crown involvement and the transfer of some risks to the Crown. Whether the development of the Model is “worth it” requires consideration of what will be required to enable the Model, whether the Model will be used and what the counterfactual is. We expand on these considerations below:

Crown involvement is vital

16. Crown involvement and the provision of statutory powers is fundamental to the Model working. Under the status quo, all decision rights and risks for the provision of local infrastructure sit with the local authority (and are ultimately borne by ratepayers). For the Model to work certain decisions rights and risks will transfer to the Crown:

    a. Final approval of the Levy will sit with the Crown;

    b. Crown will provide cover for residual risks if they arise (via a GSP), which would ordinarily sit with the local authority [38]
    [38]

    [38] There are protections in the Model to help manage the risk of the GSP being called and the extent of any call (see section five); and

    c. Due to the level of control that Crown has over the SPV (design of the SPV, approval of the Levy), pursuant to the relevant accounting standard, the assets and liabilities of the SPV will consolidate onto the Crown balance sheet. The overall impact on the Crown balance sheet should be immaterial because the assets and liabilities will offset.

17. Overall, the Model means that the Crown is more involved in the provision of local infrastructure than would ordinarily be the case. This may lead to a general expectation (above the Crown’s agreed obligations) that the Crown will step in if the SPV fails. However, Ministers should be aware that the Crown’s involvement does not constitute an underwrite or full guarantee and is designed to only cover certain contingent residual risks that cannot be borne by the local authority.

The Model involves the creation of a new Levy – with safeguards

18. It is a fundamental part of New Zealand’s constitution that powers to tax are authorised by Parliament. The levy proposed has characteristics similar to a tax – payment is compulsory and is necessarily backed by potentially punitive consequences for non-payment. Accordingly, strict oversight provisions are proposed to avoid potential abuse of the levy power. These include:

    a. the design and maximum income generated by the Levy must be approved by OIC;

    b. the Auditor-General has a statutory role to audit the financial statements of the SPV applying the Levy, whether publicly or privately owned; and

    c. there is a statutory monitor with step in powers to take over aspects of the management of the SPV necessary to ensure the levy is lawfully collected and applied.

19. Some SPV's may have monopoly like features in specific local markets. We have considered whether SPV's should be subject to regulation by an independent regulator such as the Commerce Commission. However, the Model legislation and Levy setting process (in particular the OIC) include a number of safeguards to replicate the regulatory regime for utilities and therefore provide appropriate consumer protections. At this time, extending the Commerce Act to regulate the SPVs is not recommended. Further commentary on this matter is set out in paragraph 124 to 127.

The Model will make a difference – where there are financing constraints

20. We have worked with local authorities and CIP to investigate possible projects to be funded using the Levy (see Appendix A). This has identified that there are some significant projects where using the Model will bring forward infrastructure and therefore accelerate the provision of housing. It has also identified projects where dealing with planning and consent issues will also be required. This highlights the importance of moving forward with other elements of the Urban Growth Agenda and in particular the spatial planning pillar and Resource Management Act (RMA) reform. Removing the financing barrier may encourage local authorities to deal with other constraints more quickly.

The alternatives for the Crown are not costless

21. Without some form of Crown intervention to ease financial constraints for local authorities, the delivery of infrastructure and therefore housing will remain slow. Lack of housing costs the Crown in many ways and is a significant driver of demand for Crown provision of affordable, social and emergency housing. Put simply, the status quo option will continue to cost the Crown.

22. In addition, the alternative options involve more fundamental intervention by the Crown and begin to distort the costs and benefits of infrastructure. These include:

    a. Increasing local authority borrowing capacity. This would require agreement of local authorities [33]
    [33]

    b. Government directly funding the costs of local infrastructure. This would impact on Budget Responsibility Rules.

23. [33]

24. On balance, and taking into account what the alternatives are, we think the Model is an important additional tool for financing infrastructure. It is not without risks and will require the establishment of two new functions (the recommender/facilitator and the monitor). The recommender/facilitator and the monitor have a critical role in supporting Cabinet to make informed decisions on the use of the Levy, managing the risks to the Crown and ensuring the interests of beneficiaries are safeguarded.

Strategy for rolling out the Model

25. How the Model is rolled out will be important. We recommend that the Model is initially used on greenfield sites before being rolled out to brownfield sites. This approach will enable the Model to be tested in less complex projects where beneficiaries opt in, which will reduce risk to the Crown and assist with the acceptance and understanding of the Model by local authorities, beneficiaries and the broader community.

26. At least initially, the Crown will need to own the SPV and account for its activities. A key focus over time will be minimising the risk that sits with the Crown through reducing the scope of the GSP and exploring different SPV ownership structures. Different SPV ownership structures could include joint Crown/Council or private ownership either at the time the SPV is set up, or upon construction of the asset.

27. We will also continue our engagement with the rating agencies to seek further flexibility in the Model that will reduce complexity but still meet their requirements. In particular we are keen to continue testing with rating agencies whether projects that have already been constructed by local authorities and sit on the local authority balance sheet can be refinanced using the Model.

Next Steps

28. We will shortly provide the Minister of Housing and Urban Development with a draft Cabinet paper covering the recommendations in this paper. We will follow up with the Minister of Housing and Urban Development's office regarding the circulation of the Cabinet paper to UGA Ministers and coalition partners.

29. A subsequent Cabinet paper will be required before the end of April to confirm;

    a. the extent of SPV powers during construction (specifically Resource Management Act and Public Works Act powers to acquire land and interests in land, and local authority powers to access land to manage infrastructure); and

    b. how the Model relates to the insolvency regime in New Zealand.

Consultation

30. Treasury and the DIA have consulted with the Ministry of Housing and Urban Development, Ministry for the Environment, Ministry of Transport, Ministry of Business Innovation & Employment and the New Zealand Transport Agency (NZTA). Department of Prime Minister and Cabinet, Te Puni Kokiri, Land Information New Zealand and Ministry of Justice have been informed.

Recommended Action

We recommend that Ministers:

a) **note** that in June 2018, officials reported to Ministers on options to address local authority financial constraints including: central government funding infrastructure directly; alternative financing models; local authorities selling assets to fund infrastructure; and expanding local authority borrowing through the Local Government Funding Agency.

b) **note** that in considering the June 2018 report, Ministers asked officials to focus on alternative financing models and this decision was endorsed by the Cabinet Economic Development Committee in September 2018.

The Infrastructure Levy Model

c) **agree** to the establishment of an Infrastructure Levy Model.

Agree/disagree

d) **note** that the involvement of the Crown is fundamental to the Infrastructure Levy Model working.

e) **agree** to present a Cabinet paper to the Cabinet Economic Development Committee recommending the establishment of an Infrastructure Levy Model.

Agree/disagree

f) **provide** any feedback on this report to officials.

g) **forward** a copy of this report to the Minister of Commerce and Consumer Affairs.

Levy

h) **note** that the legislation will need to include a mechanism for setting the Levy and definitions for the type of infrastructure and costs that can be covered by the Levy.

i) **agree** that the mechanism to access a Levy involves the use of an Order In Council approved by Cabinet for each project.

Agree/disagree

j) **agree** that the Levy be used to fund infrastructure projects that meet the definition in this report of 'eligible infrastructure'.

Agree/disagree

k) **note** that the legislation has a permissive scope of costs that can be funded by the Levy on the basis that the actual costs to be funded by the Levy will be agreed on a project-by-project basis.

l) **agree** the Levy regime set out in Appendix B of this report.

Agree/disagree

m) **note** that Treasury officials will report back with guidance on beneficiary identification and Levy setting principles prior to the legislation being enacted.

Proposer

n) **agree** that any 'person' be able to propose a project be funded by the Levy.

Agree/disagree

Facilitator and Recommender

o) **note** that the Infrastructure Levy Model includes a Facilitator to assist with the preparation of proposals to access the Levy.

p) **note** that the Infrastructure Levy Model includes a Recommender function to ensure Cabinet decisions on whether to use the Levy are well informed and independent of the proposer.

q) **agree** that the Recommender and Facilitator be the same entity and be Crown-appointed.

Agree/disagree

r) **note** that Treasury officials will report back on the appropriate entity to be the Recommender and Facilitator and associated funding arrangements by July 2019.

Approvals

s) **agree** that the matters to be considered by Cabinet when setting a Levy (outlined in paragraph 60 of this report) be incorporated in legislation.

t) **note** that local authorities have legitimate interests in the use of the Levy.

u) **note** that officials have developed two local authority approval options to ensure these interests are provided for in approving the Levy.

v) **select** from either of the following options;

Option 1 – Endorsement
agree that local authority endorsement is required before Cabinet can approve the use of the Model. Local authority endorsement is in relation to ensuring the assets are of an acceptable quality and are compatible with broader networks and that the financial consequences of vesting can be managed. In addition local authorities are required to endorse the Levy unless it would impact on their ability to collect revenue in the future.

Agree/disagree

OR

Option 2 – Consultation
agree that the relevant Local authority be consulted whether the assets are of an acceptable quality and are compatible with broader networks, the financial consequences of vesting can be managed, and the extent to which the Levy impacts on their ability to collect revenue in the future. Cabinet will take this consultation into account when approving the Levy, but is the ultimate decision maker. When seeking the approval of Cabinet the Recommender will put forward the local authorities' view and it will be given due consideration but is not binding.

Agree/disagree

w) **discuss** with officials if you would like further advice on requiring local authorities to accept infrastructure assets financed using the Model without their consent.

Discuss/no discussion required

Special Purpose Vehicle

x) **agree** that local authorities be required by legislation to collect the Levy on behalf of the SPV if the SPV requires it; and the parties agree terms.

Agree/disagree

y) **agree** that legislation specify that any monetary development contributions already collected for a project that is funded by a Levy be transferred to the SPV.

Agree/disagree

z) **note** that there are a range of SPV ownership options and structures.

aa) **agree** the legislation not exclude any SPV ownership options or structures.

Agree/disagree

bb) **agree** the proposed monitoring, reporting, intervention and disclosure regime for SPV's outlined in this paper.

Agree/disagree

cc) **note** that Treasury officials will report back on the recommended monitoring entity for SPV's by July 2019.

Asset transfer

dd) **note** the legislation will enable SPV's to own assets during construction and not be prevented from ownership during the term of the Levy.

Agree/disagree

ee) **note** that officials will shortly prepare a Cabinet paper regarding the proposed approach to the powers of the SPV during the construction period.

Government Support Package

ff) **note** the Government Support Package is an integral part of the rating agency requirements of the Infrastructure Levy Model.

gg) **agree** that a Government Support Package will be provided as part of projects funded by the Infrastructure Levy Model.

Agree/disagree

hh) **note** the terms of each GSP will be agreed on a case by case basis, [38]
[38]

Consequential changes

ii) **agree** to consequential changes to local government legislation to ensure consistency between the Model and local government legislation.

Agree/disagree

Insolvent Transactions

jj) **note** that officials will provide further advice on whether the Levy legislation be used to avoid a situation where parties are unfairly treated in an insolvency of the SPV.

kk) **agree** that officials from the Ministry of Business, Innovation and Employment, Department of Internal Affairs and Treasury provide further advice to Cabinet about how insolvent transactions relate to the Infrastructure Levy Model.

Agree/disagree

Stacey Wymer
Director

Hon Grant Robertson
Minister of Finance

Hon Phil Twyford
Minister of Housing and Urban Development and Transport

Hon David Parker
Minister for the Environment

Hon Nanaia Mahuta
Minister of Local Government

Hon Shane Jones
Minister of Infrastructure

Hon Julie Anne Genter
Associate Minister of Transport

Treasury Report: Infrastructure Funding and Finance: Infrastructure Levy Model

Purpose of Report

1. In September 2018 the Cabinet Economic Development Committee (DEV) directed Treasury and the Department of Internal Affairs (DIA) to report back on alternative financing models to fund local infrastructure, and any associated legislation that would be required to underpin these models.

2. The goal of alternative financing models is to free infrastructure investment from local authority financial constraints. The timely delivery of infrastructure is critical to enable and accelerate housing development and to improve housing affordability.

3. This report outlines a new alternative financing model to fund and finance local infrastructure – referred to as the Infrastructure Levy Model (the "Model"). This involves the creation of a Levy (the "Levy") paid by the beneficiaries of infrastructure projects. Legislation is required to enable the Model.

4. The purpose of this report is to:

   a. set out how the Model and Levy will work;

   b. seek agreement on the proposed policy positions to implement the Model and draft the required legislation; and

   c. identify the key risks and outstanding issues to implementing the Model.

5. The report is divided into nine sections:

   Section 1: Background

   Section 2: Objectives

   Section 3: Overview of how the Model and Levy will work

   Section 4: Infrastructure Levy Model and process

   Section 5: Government Support Package

   Section 6: Consequential amendments to legislation

   Section 7: Accounting treatment, income tax and GST

   Section 8: Risks

   Section 9: Next steps

Section 1: Background

6. This report is part of the cross-government work on the Infrastructure Funding and Financing (IFF) pillar of the Urban Growth Agenda (the UGA). The main objective of the UGA is to improve housing affordability, underpinned by affordable urban land.

7. The supply of infrastructure is currently constrained by financial restrictions on local authorities, which provide most local infrastructure. The financial restrictions are a mix of technical factors and behavioural issues that constrain borrowing by local authorities (referred to in this report as the financial constraints).

8. The technical factors include:

   a. the Local Government Funding Agency (LGFA) borrowing covenants – which require debt as a percentage of revenue to remain below 250%;

   b. the financial prudence regulations of the Local Government Act – which discourage borrowing costs rising above 15% of revenue; and

   c. the financial strategies set by each local authority as part of its Long Term Plans.

9. The LGFA covenants establish hard upper limits on the ability of local authorities to increase debt levels, while the financial prudence regulations reinforce a cautious approach to debt on the part of local authorities.

10. The behavioural issues include the desire of local authorities to retain strong credit ratings (which assists in minimising the cost of borrowing) and the self-imposed limits set up by local authorities within their financial strategies. These behaviours are a consequence of ratepayer preferences for low debt and low rates.

11. We provided you with a report in June 2018 outlining in greater detail these constraints and setting out the options available to reform the funding and financing of local infrastructure (TR 2018/1087 refers).

12. Of the options outlined in our June 2018 report, investigating alternative financing models was recommended to provide an enduring solution to the financial constraints faced in the provision of local infrastructure. In September 2018, DEV directed Treasury and DIA to report back to DEV on alternative financing models to fund local infrastructure, and any associated legislation that would be required to underpin these models.

13. Subsequently, officials have developed an alternative financing model [33]
[33]

14. [33] officials have been working with local authorities, other government agencies and legal and commercial advisors to refine and work through policy issues to implement the Model.

Section 2: Objectives

What are we trying to achieve?

15. We have sought to develop a model which enables infrastructure projects to be funded and financed without being limited by the financial constraints faced by local authorities (especially high growth local authorities). Most high growth councils are close to their maximum debt levels (debt below 250% of revenue), which constrains their ability to borrow to deliver infrastructure. A consequence of this is that there is a long list of unfunded but economically viable infrastructure projects that cannot proceed unless self-funded by developers.

16. We consider that alternative financing models should be explored because:

    a. it allows viable projects to proceed outside of the local government financial constraints and allows the system to be responsive to demand;

    b. it allows costs to fall on the communities and homeowners who benefit from the new infrastructure;

    c. it makes the viability of the project the decision, removing the trade-offs which local authorities often have to make when allocating capital;

    d. it allows for greater rigour and transparency in the allocation of risk and costs to the appropriate parties;

    e. it provides price signals to ensure investment occurs where it is most needed;

    f. it will allow for a much greater quantity of debt to be leveraged from revenue streams than would be possible through a local authority; and

    g. it provides a pipeline designed to allow new capital to flow into the system.

17. These alternative financing models would complement – rather than replace – local government infrastructure provision. The Model represents an evolution of the Crown Infrastructure Partners (CIP) model.

Key considerations in designing the model

18. The development of an alternative financing model has raised a range of policy issues. In providing advice on these policy issues and assessing different options, the following considerations have guided us:

    a. **Rating agency requirements:** The key matter that a rating agency will consider is whether the alternative financing model creates any legal or moral recourse back to the local authority. If there is recourse then the debt raised through the alternative financing model will be subject to the local authority financial constraints. Ultimately, this means that the goal of alternative financing models will not be achieved.

    b. **Public policy considerations:** This is about ensuring that the Model is consistent with general policy principles such as fairness, efficiency, sustainability and that entities undertaking investment on behalf of beneficiaries/Levy-payers are subject to appropriate accountability arrangements.

    c. **Implementation considerations:** This is primarily about the willingness of parties to use the Model including local authorities, developers and financiers.

    d. **Replicability and scalability:** This is about ensuring that the Model is fit for purpose (both for now and how it might evolve over time) and ensuring that it can be replicated across a variety of different infrastructure projects and locations.

19. These considerations are not independent of each other and in some cases trade-offs need to be made.

Why is legislation required?

20. Legislation is required to enable the Model. Primarily, the legislation is needed to allow new entities the ability to collect the Levy (akin to a targeted rate) over a long period of time (up to 50 years). This legislation will mark a significant change to the status quo in three key respects:

    a. First, it will enable new entities (Special Purpose Vehicles (SPVs)) to have statutory levying powers akin to a targeted rate. Anything less than the new entity having the power to levy directly (such as a local authority transferring or assigning their powers) will not alleviate the financial constraints faced by local authorities (i.e. the debt will still be included in the local authorities' debt to revenue ratio).

    b. Secondly, it will enable the Levies to be set for a long period of time (up to 50 years). Currently, a local authority can only set a rate for one financial year but can borrow for extended periods. This is because they have no cap on their liability and no ability to declare bankruptcy. They also have the ability to offer rates, including the ability to levy rates, as a security for borrowing. The absence of these rights for an SPV is a barrier to the financing of infrastructure projects and the SPV requires the certainty provided by multi-year Levies to secure finance.

    c. Thirdly, the SPV will be responsible for providing the infrastructure and needs powers that local authorities would usually use to achieve this.

Evolution of the Crown Infrastructure Partners (CIP) model

21. In November 2018, the Government (via CIP) and Auckland Council announced the Milldale development (Milldale) north of Auckland. Milldale involved the use of an alternative financing and funding mechanism, including the use of infrastructure payments to be paid by beneficiaries of the development.

22. While the Milldale model was able to access long term financing without being limited by the financial constraints of the local authority, it has limitations as to its replicability. This is because the Milldale model relies on a contract where beneficiaries agree to pay the infrastructure payments. This approach is difficult to replicate in a situation where there are many beneficiaries, existing beneficiaries, and/or beneficiaries who are unwilling to contribute.

23. By contrast the Model is enabled through legislation which means that identified beneficiaries are required to pay the Levy (much as homeowners are required to pay local authority rates).

Section 3: Overview of how the Model and Levy will work

24. The core of the Model involves the setting of a multi-year Levy (up to 50 years) which is paid by beneficiaries of infrastructure projects. The Levy is enabled by legislation and levied by the SPV who is responsible for financing all or part of the project, and has the power to collect the Levy.[2] The SPV may also itself (but doesn't always need to) have a direct role in commissioning construction of the project.

[2] In practice we expect the SPV will want the relevant local authority to collect the Levy on its behalf.

25. A fundamental element of the Model is the provision of a Government Support Package (GSP) to cover certain contingent residual risks. These are the contingent residual risks that would normally sit with the local authority [38]
[38] The GSP is critical to ensuring that there is no financial recourse back to the local authority and therefore ensuring that the debt of the SPV is not included in the rating agency assessment of the local authorities' borrowings. More information on the GSP can be found in section five of this report.

26. This section provides an overview of the design of the Levy. The details of the Levy regime can be found in Appendix B. Where appropriate the design of the Levy mimics many of the rating provisions within the Local Government (Rating) Act 2002 (LGRA).

Setting of the Levy

27. A Levy for each infrastructure project will be set by Order in Council (OIC). The OIC will set out the details of the Levy including:

   a. the amount that can be recovered, and any relevant milestones;

   b. the term of the Levy (expected to be 25 – 50 years);

   c. the beneficiaries of the project who will be subject to the Levy; and

   d. the basis of allocating the Levy between beneficiaries.

28. The OIC may also set out further conditions or limitations on the use of a Levy for a project (for instance, a limit on the amount of Levy revenue that can be applied to costs such as the equity return).

29. We considered whether Cabinet (by OIC), a delegated Minister, a delegated Crown body or a delegated local authority should approve the use of a Levy. Our legal advice was that Cabinet approval of a Levy via an OIC was the most constitutionally robust approach and therefore, reduces the risk of judicial review of the Levy.

30. We propose that the legislation enable a permissive approach to beneficiary identification and allocation of the Levy between beneficiaries[3]. Under the proposed approach it will be possible for the Levy to be phased to incentivise development (e.g. larger amounts upfront and smaller amounts in later years) or to be allocated according to those that benefit the greatest from the infrastructure (e.g. by proximity to infrastructure).

31. Feedback from local and central government is that the process of identifying beneficiaries and allocation choices can be complex and we intend to issue policy guidance to assist in those decisions.

Use of the Levy

32. The Levy is to be used to fund new infrastructure projects and upgrades to existing infrastructure by agreement with the Crown and relevant local authority/s (more information on the approval process for the Levy can be found in section four).

[3] The allocation of the Levy among beneficiaries could depend on various factors, such as; geographical land area; use of land; activities permitted on land; and value of the land.

33. We have developed a scope of 'eligible infrastructure' to define the type of projects that a Levy can be used for. In setting the scope of eligible infrastructure we considered:

    a. The range of infrastructure required to enable housing and urban development including ancillary infrastructure (such as community facilities).

    b. Broader infrastructure requirements to unlock housing or to enable housing between urban centres (including projects which may span several local authorities).

    c. Definitions of infrastructure used in potentially relevant statutory definitions, by CIP and the eligibility criteria applied by the Housing Infrastructure Fund.

    d. Whether infrastructure is typically funded by local authorities or through central government funding.

    e. Whether there are existing and well-functioning funding and financing mechanisms in place for certain types of infrastructure.

34. Taking into account these considerations, the proposed scope of eligible infrastructure means new or upgraded infrastructure within the following categories:

    a. water, wastewater, stormwater

    b. transport and associated infrastructure (including bridges and tunnels), and cycleways and footpaths [to include local roads and State Highways]

    c. public transport infrastructure, including rail, busways, park and ride, exchanges, stations, shelters

    d. community amenities to the extent they form a part of a wider project

    e. environmental resilience infrastructure, such as flood protection, pump stations and environmental restoration

35. The scope will expressly exclude:

    a. housing

    b. any gas, telecommunications, electricity, or other services networks

    c. solid waste disposal or recycling; and

    d. schools, hospitals, prisons, social housing.

36. The proposed legislation to establish the Housing and Urban Development Authority (HUDA) may contain some relevant definitions and we will take these into account during the legislative process.

Costs funded by the Levy

37. The legislation will need to articulate what costs can be funded by the Levy. We recommend the legislation make it possible for a wide range of costs to be covered by the Levy. The exact make-up and extent of the costs to be covered by the Levy will be considered on a project-by-project basis taking into account affordability for the beneficiaries. The proposed list of eligible costs to be included in legislation are listed below:

    a. Construction costs – including direct construction costs, insurance and project contingency costs.

    b. Project establishment costs of the Proposer, Facilitator (where these are directly attributable to a specific project funded by the Levy), bidders[4] and SPV owner, with limitations governing eligibility set out in guidance material.

    c. SPV operating costs including management and administration costs.

    d. Asset operating and maintenance costs prior to vesting.

    e. Financing costs including debt interest costs, equity costs (where relevant), arrangement, commitment and agency fees and reserve accounts.

    f. Enforcement and intervention costs.

    g. Levy collection costs most of which will be paid to a local authority to collect the Levy.

    h. SPV monitoring costs.

    i. [38]

    j. Any of the costs referred to in (a) to (c) above that have been incurred by another party and which the SPV is liable to fund or reimburse (this would be the case in a situation where the SPV did not construct the assets or took over the construction of assets from a local authority and used Levy revenue to repay local authority debt).

Recommended actions:

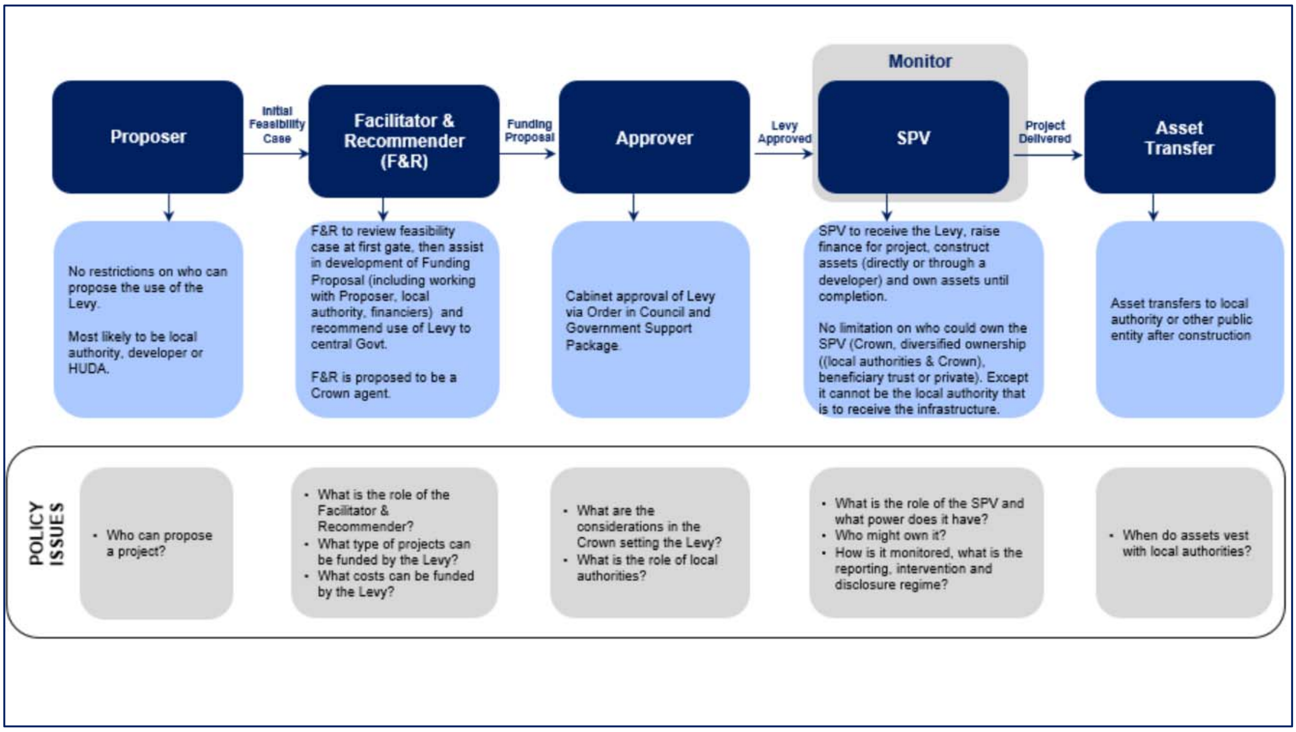
note that the legislation will need to include a mechanism for setting the Levy and definitions for the type of infrastructure and costs that can be covered by the Levy.
agree that the mechanism to access a Levy involves the use of an Order In Council approved by Cabinet for each project.
agree that the Levy be used to fund infrastructure projects that meet the definition in this report of 'eligible infrastructure'.
note that the legislation has a permissive scope of costs that can be funded by the Levy on the basis that the actual costs to be funded by the Levy will be agreed on a project-by-project basis.
agree the Levy regime set out in Appendix B of this report.
note that Treasury officials will report back with guidance on beneficiary identification and Levy setting principles prior to the legislation being enacted.

[4] Including potentially unsuccessful bidders whose costs are considered reasonable by the Facilitator and Recommender.

Section 4: Infrastructure Levy Model and process

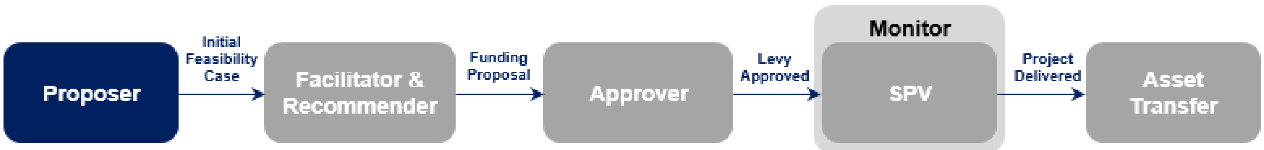
38. This section describes in more detail the process to take a project from conception through to being funded by a Levy and then (if not already in public ownership) transferred back to a public entity. In doing so, we identify the key policy issues (bottom row of the following diagram) and address these.

Process for setting a Levy



39. This section is ordered by following the progress of a project starting with the role of the 'Proposer' below.

Proposer



40. The role of the Proposer is to identify and put forward a project to be considered to be funded by the Levy. To encourage uptake of the Model (and given the range of other safeguards in place to ensure the Levy is used appropriately), we have not limited who can propose that a project be funded by the Levy. In practice, we expect the most likely Proposers will be local authorities, developers and the HUDA.

41. In addition, there will be guidance available to the Proposer to inform them about the type and likely size of projects that could be funded by the Levy, process for getting a Levy approved and beneficiary identification and allocation methods. This guidance will help to ensure that projects which have a realistic prospect of getting approved for a Levy are put forward.

Recommended actions: **agree** that any 'person' be able to propose a project be funded by the Levy.

Facilitator and Recommender

42. As the approver of the Levy (and any GSP), the Crown will need to be advised by a party independent of the Proposer on whether to approve a Levy. We propose that the Crown appoint a party to act as both the recommender of the Levy (the Recommender) and also to facilitate and filter proposals from Proposers seeking to access the Levy (the Facilitator).

43. We considered separating the role of the Facilitator and Recommender as there is a potential conflict of interest between facilitating proposals and then objectively recommending which proposals are approved by Cabinet. However, we consider that this issue can be managed by either the Ministry of Housing and Urban Development or the Treasury providing second opinion advice to Ministers on the recommendations made by the Recommender. In addition we expect the Facilitator and Recommender will need to work closely with other agencies across Central Government to ensure that projects are sequenced in a coherent manner, especially where a project places pressure on other sectors (e.g. the provision of connecting transport by NZTA).

44. We also considered whether there should be one or multiple Facilitators. We concluded that having one Facilitator would be efficient, lead to consistent advice about the use of the Levy and enable a body of expertise to be developed to ensure that the Model is replicable.

45. A decision on who acts as the Facilitator and Recommender is not required for legislation. We recommend the Recommender and Facilitator role be undertaken by a Crown-appointed body. However, further work is required to identify who the Crown-appointed body will be and how they will be funded. Consistent with their current role, one option is for CIP to be the Facilitator and Recommender. Treasury will provide a separate report back on these matters.

46. The Facilitator will receive an Initial Feasibility Case from the Proposer, covering:

   a. project background and objectives;

   b. current state of the project;

   c. proposed asset and SPV ownership model;

   d. who the Proposer is; and

   e. an estimate of the amount of the Levy to be paid by beneficiaries.

47. The purpose of the Initial Feasibility Case is to provide a high level assessment of whether the Model is suitable for the project, without incurring significant cost for either the Proposer or the Facilitator.

48. Once through this initial assessment[5], the Proposer (with assistance from the Facilitator) will develop the Funding Proposal, which will be used for final approvals and negotiation of any GSP. As part of the approval the Recommender will review the final Funding Proposal, which will need to include:

   a. a detailed project overview including information on the consents that have, or will need to have, been obtained to proceed with construction of the asset(s);

   b. detail on the structure and application of the Levy;

   c. the commercial and financial business case for the project;

   d. how the infrastructure will be procured; and

   e. an assessment of the Levy against the Central Government approval criteria (see "Approver" section below).

> Recommended actions:
>
> **note** that the Infrastructure Levy Model includes a Facilitator to assist with the preparation of proposals to access the Levy.
> **note** that the Infrastructure Levy Model includes a Recommender function to ensure Cabinet decisions on whether to use the Levy are well informed and independent of the Proposer.
> **agree** that that the Recommender and Facilitator be the same entity and be Crown-appointed.
> **note** that Treasury officials will report back on the appropriate entity to be the Recommender and Facilitator and associated funding arrangements by July 2019.

Approver

49. The legislation needs to explain who approves the Levy for a project. The ultimate approval right will reside with the Crown (Cabinet), which will have the right to approve (or reject) a Levy by OIC. There are choices for how involved local authorities are in the approval process.

50. Local authorities will be required to provide all other project approvals (including the approval of consents) as they normally would. This approval section relates only to the approval of the use of the Model and Levy for a project.

[5] Any projects that do not pass the high level assessment will be referred back to the Proposer to consider whether they are re-scoped or whether the proposal to use the Model is abandoned.

Local Authority Role

51. This section sets out the following:

    a. the key points of interest for local authorities in using the Model;

    b. how the approval process in the Model could provide for local authority interests; and

    c. whether the local authority approval process should be included in legislation.

52. When considering the role of local authorities in the approval process for the Model, the following key factors are relevant:

    a. Local authorities have genuine interests (outlined in the table below) in the use of the Model; in particular they will have ongoing responsibility for the assets.

    b. The Government is increasingly seeking to work in partnership with local authorities to address urban growth challenges.

    c. The Government is seeking to decouple local authority decisions on planning from local authority financial constraints.

    d. The potential reluctance of local authorities to use the Model and Levy due to political considerations.

53. The approach taken will depend in part on the weightings of these factors. We note that the Model is only intended to overcome the financing constraint for local infrastructure and does not deal with planning and consenting issues.

54. Analysis of these matters can be found in the table below.

<table>
<tr><th colspan="2">Summary of local authority interests and approval options</th></tr>
<tr><td>What are the key points of interest for local authorities in using the Model?</td><td>We do not consider that local authorities should have broad approval rights in relation to the use of the Model. Rather any rights should be focussed on the key points of interest for the local authority; being:

1. Practical and financial interests relating to the asset vesting back to the local authority:

a. asset quality/compatibility with wider networks – whether the assets are built to required standards and compatible with existing networks (and whether any wider network effects can be managed); and
b. ability for the local authority to plan for and meet the operational and maintenance (O&M) costs once the asset has vested. These costs could be significant and in the range of 2% to 5% of the capital cost annually ($100M project would equate to annual O&M costs of $2M to $5M and on a $1Bn project would equate to annual O&M costs of $20M to $50M).

2. Affordability – whether the payment of the Levy will compromise their ability to collect rate revenue from beneficiaries.</td></tr>
</table>

<table>
<tr><th colspan="2">Summary of local authority interests and approval options</th></tr>
<tr><td>How will the approval process in the Model provide for local authority interests?</td><td>We have developed two broad options for local authority approvals for Ministers to consider. The main difference between the options below is whether local authority has a binding (endorsement) or non-binding (consultation) role in approving the use of a Levy.

Option 1: Endorsement – Local authorities are required to endorse that the assets are of an acceptable quality and are compatible with broader networks and the financial consequences of vesting can be managed. In addition local authorities are required to endorse the Levy unless it would impact on their ability to collect revenue in the future.

Option 2: Consultation – Local authorities are consulted on; whether the assets are of an acceptable quality and are compatible with broader networks, the financial consequences of vesting can be managed, and the extent to which the Levy impacts on their ability to collect revenue in the future. When seeking the approval of Cabinet, the Recommender will put forward the local authorities' view and it will be given due consideration but is not binding.

Practically, however, because of the requirement to vest the asset back to the local authority, the local authority does have a potential veto right under either option.

To remove this veto would require either:

1. The SPV to continue to own and maintain the asset. Whilst the legislation does not preclude this from occurring, there are a number of challenges involved in the SPV owning and operating assets in the long term, such as restrictions on who can own land that has a legal 'road' status and statutory conditions attached to the terms under which a local authority can enter into arrangements for the provision of water services.

2. The legislation to include provisions to force the local authority to accept the assets. This approach would:

a. be inconsistent with the broader partnership approach that the government is promoting with local authorities;
b. restrict a local authorities' ability to effective conduct their duties and meet their obligations under the Local Government Act 2002; and
c. potentially lead to a request for financial support from the Crown as the financial consequences of taking the assets could be significant.

3. Utilising the HUDA. This is because the HUDA has a framework for managing:

a. physical operation and management of assets while vesting occurs (the HUDA itself will manage assets, whereas the SPV's under the Model will not be able to do this easily);
b. how assets will be vested to the local authority; and
c. consenting issues which would be required in the event a local authority is not supportive of the project.</td></tr>
<tr><td>Is the local authority approval process included in the Model legislation?</td><td>Official's preferred approach is that local authority approval rights (whether it be option 1 or option 2) should be prescribed in legislation and relate only to the three matters above (i.e. the local authority should not have broad approval rights in relation to the use of the Model). Legislation provides clarity of what is expected of both local authorities and Ministers.</td></tr>
</table>

Approval of any other roles or support

55. For any given project there may also be other support requested from a local authority. This might include a direct financial contribution to a project from a local authority and/or any operation and maintenance contracts with the SPV that may be required.

56. Local authorities will negotiate these matters on their own terms. However, there is no approval mechanism required in the Model (and legislation) to enable this to occur as a project is progressed.

Timing of local authority approval rights

57. The timing of approvals is likely to vary from project-to-project. Subject to the agreed approach on the role of local authorities, the legislation should require that all necessary approvals are held before a project and Levy are approved by an OIC. In practice, the timing of approvals will be important and where possible these should occur:

    a. as early in the process as is possible (to provide the parties with assurance to proceed with developing a funding proposal); yet

    b. still late enough to ensure that approvals are based upon developed proposals that can be costed with reasonable accuracy.

58. Subject to the agreed approach on the role of local authorities, we propose that local authority confirmation (to the extent required) is provided at two stages of the process:

    a. An **in-principle Letter of Commitment** at the feasibility stage. This is intended to ensure that time and resources are only committed to advancing proposals for viable projects.

    b. A **formal endorsement or consultation statement** at the approver stage[6].

Crown approval process

59. Cabinet will have discretion to approve a Levy by OIC on the advice of the Recommender and Facilitator. The OIC will include the specifics of the Levy (as outlined in paragraph 27 above). If a GSP is required for the project it will be approved by Cabinet, on the advice of Treasury, at the same time as the OIC is considered.

60. We recommend the following matters be considered by Cabinet when setting a Levy and be incorporated in legislation. These are loosely based on the Local Government Act 2002 (LGA)[7] and include:

    a. the distribution of benefits between the project community (as a whole), identifiable parts of the project community, and individuals;

    b. the period in or over which those benefits are expected to occur;

    c. the extent to which the actions or inaction of particular individuals or a group contribute to the need to undertake the project;

    d. the extent of any other contribution towards the costs of the project;

[6] Before an OIC is approved, the affected local authority will be required to formally endorse or provide a consultation statement covering the matters described in the table under paragraph 54.
[7] Specifically, section 101(3).

e. the affordability and sustainability of the Levy over the intended period;

f. any other matters of practicality, efficiency or equity relevant to the Levy; and

g. the extent of benefits (if any) outside the project community.

61. The benefit of including these matters in legislation is that it provides some clarity to Proposers and the Recommender and Facilitator whilst preserving options for Cabinet to place weightings on different matters that are the most important to them, and to accommodate a wide range of potential projects.

62. We expect that the Funding Proposal prepared by the Facilitator and Recommender will provide an assessment of the proposal against each of the considerations to help inform Cabinet's decision.

Recommended actions:

note that local authorities have legitimate interests in the use of the Levy.
note that officials have developed two local authority approval options to ensure these interests are provided for in approving the Levy.
select from either of the following options;

- **Option 1 - Endorsement**
  agree that local authority endorsement is required before Cabinet can approve the use of the Model. Local authority endorsement is in relation to ensuring the assets are of an acceptable quality and are compatible with broader networks and that the financial consequences of vesting can be managed.
  In addition local authorities are required to endorse the Levy unless it would impact on their ability to collect revenue in the future.

<u>OR</u>

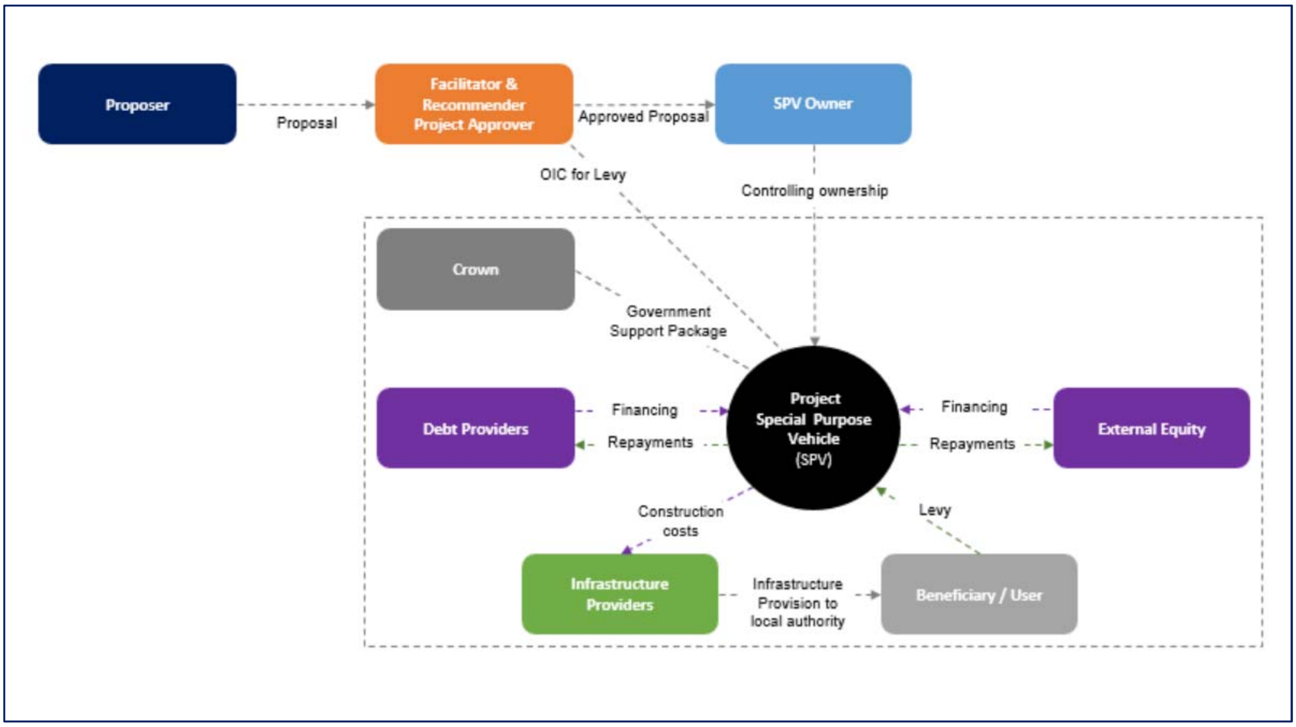
- **Option 2 - Consultation**
  agree that the relevant Local authority be consulted whether the assets are of an acceptable quality and are compatible with broader networks, the financial consequences of vesting can be managed, and the extent to which the Levy impacts on their ability to collect revenue in the future. Cabinet will take this consultation into account when approving the Levy, but is the ultimate decision maker. When seeking the approval of Cabinet the Recommender will put forward the local authorities' view and it will be given due consideration but is not binding.

discuss with officials if you would like further advice on requiring local authorities to accept infrastructure assets financed using the Model without their consent.

agree that the matters to be considered by Cabinet when setting a Levy (outlined in paragraph 60 of this report) be incorporated in legislation.

Special Purpose Vehicle (SPV)

63. The use of an SPV that is not owned by the local authority is required to ensure infrastructure projects can be delivered without being limited by local authority financial constraints. The diagram below sets out how the SPV is ring-fenced from local authorities and its relationship with debt and equity providers.



64. The Levy provides the SPV with access to a long-term funding stream that enables capital to be raised to finance infrastructure. The SPV will:

a. collect the Levy;

b. raise capital (utilising the Levy revenue stream);

c. finance infrastructure;

d. commission construction and transfer the infrastructure to the relevant local authority (or other relevant public entities) – if the SPV has a direct role in construction for any project; and

e. repay any finance raised for infrastructure.

Collection of the Levy

65. The SPV will be empowered through legislation to collect the Levy. The legislation will enable the SPV to collect the Levy directly (invoicing beneficiaries directly) or by entering into an arrangement with the relevant local authority for it to collect the Levy on behalf of the SPV (where the Levy would be included as a separate line item on the rates bill).

66. We believe the optimal arrangement is for the SPV to enter into a collection arrangement with the local authority. This is from an efficiency perspective (local authorities have existing systems in place to allocate and collect the Levy from beneficiaries) and to enhance the bankability of the Model (default risk on items charged through the local authority rates bill is low). On the Milldale project undertaken by CIP, the financiers noted that the collection agency arrangement with the relevant local authority was critical to securing a lower financing rate.

67. There is a choice about whether the local authority be required by legislation to enter into a collection agreement with the SPV or whether the SPV is required to negotiate this on a project-by-project basis. Allowing local authorities to decide if they want to enter into an agreement with the SPV is consistent with central government wanting to work in partnership with local authorities. However, the efficiency and bankability considerations are fundamental to the Model working in practice.

68. Therefore, we recommend that the legislation require that the relevant local authority collect the Levy, if requested to do so by the SPV. This requirement will be subject to the SPV covering the local authorities' reasonable costs and expenses in providing the collection service. A disputes resolution process may be required if agreement cannot be achieved.

69. This legislative requirement would cover the standard collections role only (e.g. including the Levy on the rates bill, reminder notices and collecting and accounting for payments). The legislative requirement would not extend to enforcement action – as we expect there would be considerable resistance from local authorities to taking enforcement action on behalf of another party (however a local authority could still agree to perform such a role by agreement).

Security, Priority and Enforcement of the Levy

70. The Model's security, priority and enforcement regime has been modelled on the LGRA, which applies to local authority rates. This means that the Levy will effectively be secured against the land in the same manner as local authority rates and have priority behind local authority rates but ahead of any other claims against that land (e.g. mortgages) on enforcement. In practice if a Levy is unpaid and enforcement action is required, the amounts recovered would be applied first towards any unpaid rates and then towards the Levy.

71. If there is more than one Levy being levied on the same unit of land, the Levies will have priority in the order in which they came into existence (i.e. the earlier Levy will have priority over the later Levies). This provides certainty because the SPV with the subsequent Levy will be aware of earlier ones, so can factor this into their models. This ensures that the security of earlier Levies are not undermined by subsequent Levies (similar to the ranking of mortgages and secured charges).

Raising finance

72. The SPV will raise finance and enter into financial arrangements (such as hedging) in relation to the infrastructure project.

73. We expect the SPV will need to manage two finance risks in the course of its operations; base rate risk and margin risk. Encouragingly in the Milldale transaction the Accident Compensation Corporation provided a 35 year fixed interest rate. This reflects a positive evolution in the development of New Zealand capital markets. It will enable better matching of debt with the length of the proposed Levy (25 to 50 years) and should reduce the risk that the Crown is required to take financing risks.

Construction of the infrastructure

74. There are a range of ways in which the SPV could provide infrastructure. The possible structures include the SPV constructing infrastructure assets by subcontract or the SPV providing finance to a third party (e.g. a developer) to construct the infrastructure.

75. In order to retain flexibility, we recommend that the legislation should not prescribe or restrict the SPV to utilise particular structures for the construction of the infrastructure.

Contribution of development contributions

76. It is possible that a local authority may have already begun collecting (or have the right to collect) development contributions under the LGA for a particular project. It is proposed that the legislation will require the transfer of relevant existing development contributions to the project being funded by the Levy.

77. To prevent double charging, previously paid development contributions may be a factor in the design of the Levy. In addition, once the Levy has commenced, development contributions will not be permitted for the project infrastructure to be financed by the SPV. This will not preclude developers making voluntary capital contributions to expedite their ability to proceed.

SPV ownership

78. SPV ownership structures could range from Crown owned through to privately owned. The only SPV ownership structure that would not work is ownership by the local authority that is to receive the infrastructure (which would not meet rating agency requirements).

79. We propose that the legislation retain sufficient flexibility to enable any ownership option.

80. Officials at the high growth councils have expressed a strong preference that the SPV be at least initially owned by the Crown on the basis that the Model represents a significant change for their elected members and that non-Crown ownership of the SPV may negatively impact on uptake of the Model. We consider that local authority buy-in for the Model is important and this means that it may be necessary for the Crown to own the SPV's initially.

81. However, this approach has implications for the Crown balance sheet and may set a precedent for future projects funded by the Levy. We will provide further advice on SPV ownership so that Ministers can make a decision on SPV ownership preferences in advance of the legislation being introduced into Parliament.

Monitoring, reporting and intervention regime

82. Given the levying powers being provided to the SPV a robust monitoring, reporting and intervention regime is essential to ensure transparency, oversight and, that, ultimately the Levy is resistant to challenge. The proposed regime is set out in the table below:

Monitoring	Reporting	Intervention
Crown-appointed Monitor for each SPV. Monitor to approve application of OIC by SPV (e.g. approval of annual Levy calculations). Monitor to receive periodic reporting from the SPV in respect of the Levy and the project. Monitor to receive reporting from the SPV on material events and to be able to require information from the SPV. Monitor to receive and action any complaints.	SPV required to release its audited Annual report. No Official Information Act requirements (unless they already exist (i.e. if SPV is Crown/local authority)) as the Monitor will most likely be subject to the OIA.	Power for the Monitor to direct the SPV to address significant problems with the Levy. Power for the Crown to exercise SPV's rights if the SPV has not complied with the Monitor's previous direction to address significant problems with the calculation of the Levy.

83. A decision has not yet been made on who the appropriate Monitor is for the Levy. A report back will be provided on this matter at the same time as a recommendation on the entity to be the Facilitator and Recommender.

Disclosure regime

84. To ensure that beneficiaries and other interested parties (such as prospective purchasers of land that is subject to a Levy) are aware of and understand the implications of the Levy. We recommend that the legislation include a disclosure regime that addresses mandatory disclosure to beneficiaries, mandatory disclosure to interested parties on request and mandatory public disclosure.

<u>Mandatory disclosure to beneficiaries</u>

85. We recommend that the regime for mandatory disclosure to beneficiaries be modelled on existing LGRA provisions – in particular including requirements that:

   a. levies be disclosed to beneficiaries on an annual "assessment" (either an SPV assessment or a rates assessment where a local authority is acting as collections agent) which provides a full description of the Levies – as with rates, the issuance of the assessment would establish the liability to pay the Levy; and

   b. an invoice must be sent to beneficiaries when a payment is due (either by the SPV or by a local authority where it is acting as a collections agent).

Mandatory disclosure to interested parties on request

86. The proposed regime for mandatory disclosure on request consist of:

    a. an obligation on local authorities to disclose Levies in Land Information Memoranda (LIMs), which can be obtained for a fee by any person, at any time, for any property and from one known and central place – this would involve an amendment to the Local Government Official Information and Meetings Act 1987, and would also be supported by an obligation on the SPV to provide the local authority with the requisite information about the Levies for this purpose if the local authority is not collecting the Levy; and

    b. an obligation on local authorities to include information about Levies on the rates record for any property – we recommend this option as inspection of the rates records is often an alternative/supplement to obtaining a LIM. It is free, unlike a LIM, and is part of the standard conveyancing procedure to inform what rates apportionments are required on settlement.

Mandatory public disclosure

87. Finally, we recommend that the proposed regime for mandatory public disclosure consist of:

    a. an obligation for there to be a publicly accessible website maintained with all information in relation to Levies – people would be made aware of the website through their interactions with a relevant local authority when obtaining a LIM, or undertaking a search of rates records. This is similar to the Milldale project, where a website has been established with information on the amounts payable by landowners; and

    b. a statutory role for the Monitor (or other suitable Crown body) to inform the public on how the Model works and its impact on properties – we have recommended such a role as it will be important that beneficiaries and communities are informed about the effect of Levies, and their impact on properties. In particular, beneficiaries will need to understand the Levies so that they can be taken into account when agreeing to purchase a property. This may involve, for instance, the operation of the website referred to above, and other measures to ensure the public have access to information on how the Model works.

88. We also considered whether to require the Levies be registered on certificates of title to land. However, we do not consider that such an approach is required as a registration obligation would go well beyond the existing disclosure regime for rates, would add on some additional cost to the SPV, could be an inconvenience to the land owner, and in our view is not likely to provide for significantly more effective disclosure (over and above the measures we have recommended).

Recommended actions:

agree that local authorities be required by legislation to collect the Levy on behalf of the SPV if the SPV requires it; and the parties agree terms.
agree that legislation specify that any monetary development contributions already collected for a project that is funded by a Levy be transferred to the SPV.
note that there are a range of SPV ownership options and structures.
agree the legislation not exclude any SPV ownership options or structures.
agree the proposed monitoring, reporting, intervention and disclosure regime for SPV's outlined in this paper.
note that Treasury officials will report back on the recommended monitoring entity for SPV's by July 2019.

Asset Transfer

89. Assets constructed under the Model will vest in the entity that typically owns these assets (e.g. local authority, council-controlled organisation). We have investigated options for when vesting could occur and whether there are any restrictions or other legal implications of an SPV owning and/or operating assets at various points of the asset life-cycle. These options included:

Ownership of the infrastructure asset	Commentary
SPV never owns the asset (asset is always owned by the local authority)	**Not recommended** – This is unlikely to meet the requirements of the rating agency – although the legislation will not expressly preclude this option to preserve future flexibility.
SPV owns the asset during construction but the asset vests with the relevant local authority at the end of construction	**Recommended** – This will meet rating agency requirements. Will require SPV to have some legislative powers during the construction period. Will mean the assets is vested back to the local authority after construction and will form part of the asset network.
SPV owns the asset for the duration of the Levy and operates the asset	**Not recommended –** This would require the SPV to have a number of legislative powers to operate and maintain the asset over the term of the Levy (25 to 50 years) that are not generally provided to non-government bodies. It also means that the asset does not form part of the network. For these reasons this option is unlikely – although the legislation will not expressly preclude this option to preserve future flexibility.

90. The recommended option balances meeting rating agency requirements and limiting the legislative powers required by the SPV.

Powers required by the SPV during construction

91. The current legislative settings assume that the type of infrastructure possible under the Model will be constructed, owned and operated by either local authorities or central government agencies. As a consequence provisions within the Resource Management Act 1991(RMA), the Public Works Act 1981 (PWA), and some sections in the Local Government Acts 1974 and 2002 present impediments to the preferred option of the SPV constructing the assets.

92. For the Model to succeed, there needs to be an appropriate mechanism to enable land to be designated for the works to be constructed by the SPV, and enabling compulsory acquisition of land for those works if necessary. The SPV may need, in some circumstances, the ability to exercise (or have someone exercise on their behalf) powers that are currently reserved for local authorities.

93. There are a range of options for dealing with these issues. Officials from interested agencies have had an initial discussion but have not agreed a preferred option at this stage. Officials will report back to Cabinet with further advice shortly.

94. The Ministers for Māori Development and Land Information are undertaking broader work on the issues and options for the treatment of Māori land under the PWA. This includes both the acquisition of Māori land and the offer back of former Māori land under the PWA. No firm policy decisions have been made yet as options are still being developed. Officials advise against making any specific decisions in relation to the treatment of Māori land under the Model legislation until the broader work has been completed. This will ensure that SPVs are treated consistently with other network utility operators.

Recommended actions:

note the legislation will enable SPV's to own assets during construction and not be prevented from ownership during the term of the Levy.
note that officials will shortly prepare a Cabinet paper regarding the proposed approach to the powers of the SPV during the construction period.

Section 5: Government Support Package (GSP)

95. Currently, in the delivery of infrastructure projects funded by local authorities, the relevant local authority takes on the contingent residual risks that are not transferred to another party (either because these risks cannot be transferred or will not be priced efficiently). [38]
[38]

96. For projects progressed under the Model, these risks will exist. However, these risks can't be borne by local authorities without impacting on the rating agency assessment of local authority finances. In addition, rating agencies' indicated any risks that are not explicitly allocated will be assumed to rest with the local authorities. If these risks remain with the local authorities, then there is financial recourse to the local authorities and the Model won't work.

97. Therefore, contingent residual risks will need to be explicitly allocated. Aside from the local authorities, the other options for who could bear these risks include:

   a. Financiers – [38]
   [38]

   b. Beneficiaries – [38]
   [38]

   c. Contractor - To the extent possible we expect the SPV will enter into fixed price contracts or a certain level of contingency will be included in the contract. [38]
   [38]

   d. Crown – while this approach is not costless for the Crown, and would require risks to be monitored, it is consistent with the risk position that the Crown takes on large Crown funded infrastructure projects (e.g. transport projects).

98. To ensure the cost of managing these risks are minimised and to make the Model work we propose that residual risks associated with infrastructure projects funded by the Levy sit with the Crown via a GSP. The GSP will be in place for the life of the Levy, but will be scaled back at the end of the construction phase, which is when the risks are the greatest.

99. In addition, we have considered how calls on the GSP could be mitigated – this includes:

a. building a contingency into the Levy to cover potential risks (likely to be most applicable to deal with construction cost overruns and financing related risks);

b. independent due diligence in relation to construction cost, contractors and developers;

c. use of insurance; and

d. ensuring appropriate governance structures including robust monitoring, reporting and intervention regimes.

[38]

101. The GSP will be provided on a case by case basis by contract between the Crown and the SPV. Treasury will be responsible for making independent recommendations to Cabinet on the use of the GSP. This provides a level of independence from the project and will help ensure that there are the appropriate incentives to ensure that the GSP is minimised.

102. Cabinet ultimately retains the right to decide on the scope and scale of the GSP on a case by case basis.

Recommended actions:

note the Government Support Package is an integral part of the rating agency requirements of the Infrastructure Levy Model.
agree that a Government Support Package will be provided as part of projects funded by the Infrastructure Levy Model.
note the terms of each GSP will be agreed on a case by case basis, [38]
[38]

Section 6: Consequential amendments to legislation

103. Officials have also considered the need for consequential amendments to legislation to ensure the Model will work.

Local Government Legislation

104. We propose amendments to the Local Government Official Information and Meetings Act, LGRA and Land Transport Management Act. Specific changes are required to clarify that:

   a. the Model is not inconsistent with the Local Government Act[8]; and

   b. the Model can be used by Auckland Water Organisations (i.e. Watercare) without placing them in breach of their obligation to keep the overall costs of water supply and waste-water services to its customers at the minimum levels.

Insolvent transaction provisions in the Companies Act 1993

105. The Model will involve an SPV constructing assets and vesting those assets in a public body, such as a local authority. The local authority will not be required to pay for those assets, rather payment for the assets is funded by the beneficiaries through the Levy.

106. This is a fundamental feature of the Model, but may have unintended consequences in the event of an insolvency of a SPV. The insolvent transaction provisions enable a liquidator to reverse a transaction where the recipient has not *directly* paid full value for the asset. In the Model, the local authority will not *directly* pay full value of the asset to the SPV, the value is paid for by the beneficiaries. In a liquidation, this could result in a scenario where beneficiaries are paying for the asset and the local authority has to pay the liquidator again for the asset.

107. Officials will provide further advice to Cabinet on whether the Levy legislation needs to address this issue.

Recommended actions:

agree to consequential changes to local government legislation to ensure consistency between the Model and local government legislation.
note that officials will provide further advice on whether the Levy legislation be used to avoid a situation where parties are unfairly treated in an insolvency of the SPV.
agree that officials from the Ministry of Business, Innovation and Employment, Department of Internal Affairs and Treasury provide further advice to Cabinet about how insolvent transactions relate to the Infrastructure Levy Model.

Section 7: Accounting treatment, income tax and GST

108. Due to the bespoke legislative and commercial structure of the Model there are a number of GST, income tax and accounting treatment impacts to be aware of. The positions below set out the indicative position but this may change if there are material amendments to the Model.

[8] Sections 136 and 137 of the LGA do not apply to a funding arrangement approved by the Crown under the Model - without such a provision, aspects of the Model could be argued to be inconsistent with provisions (in particular, the provisions in s137 requiring local government organisations to retain control over the pricing of water services and the development of policy related to water services).

Accounting Treatment

109. A key driver in determining the accounting treatment is who controls the SPV. Accounting standards mean that the party that controls the SPV will need to consolidate the SPV's assets and liabilities onto its balance sheet. Control may result from ownership interest and commercial and other binding arrangements.

110. Regardless of who owns the SPV, the Crown will most likely control the SPV. This is because of:

    a. the Crown's involvement in the SPV's purpose and design;

    b. the Crown's ultimate right to approve the details of the OIC;

    c. the fact that the local authorities and ultimately the Crown will receive the benefit of the infrastructure assets constructed and financed by the SPV; and

    d. that significant risks related to the SPV's activities are expected to be borne by the Crown through the GSP.

111. The table below provides analysis of the circumstances under which the SPV would or wouldn't consolidate onto the Crown's balance sheet[9]. This will need to be worked through on a project-by-project basis. Scenario one and two seem the most plausible at this time, but if the Model evolves, non-consolidation may be possible.

Scenario	Crown owns the SPV	Crown controls the SPV	Does the SPV consolidate onto Crown balance sheet?
1	Yes	Yes	Yes - the Crown fully consolidates the assets and liabilities of the SPV. The impact of this on the Crown balance sheet will be limited to a grossing up of the assets and liabilities of the SPV (i.e. it is not expected to result in the recognition of material additional net liabilities). Any net difference will likely reflect a timing difference only.
2	No (SPV privately owned or diversified ownership)	Yes	Yes
3	Yes	No	No – would only reflect Crown's investment in SPV as owner.
4	No (SPV privately owned)	No	No

Income Tax

112. The advice is that the activities of the SPV will be considered under the financial arrangement rules – which means that the revenue and expenses should both be spread over the term of the project, minimising the risk of a significant timing mismatch and therefore upfront tax liability with refunds occurring over the period of the Levy. Liaison with the Inland Revenue Department (IRD) will be required to confirm this.

[9] Note that the SPV's balance sheet will reflect its assets and liabilities in all of these scenarios as whether the Crown consolidates the SPV or not has no impact on the SPV's balance sheet.

GST

113. There are two considerations in relation to Goods and Services Tax (GST). The first is whether GST should apply to the Levy and the second is whether the SPV is carrying out a taxable activity (and can therefore claim GST on costs incurred).

Whether GST applies to the Levy

114. The initial advice is that GST would not apply to the Levy. This is because statutory levies are generally not subject to GST as they are not consideration for a supply (i.e. they are not sufficiently linked to a supply of goods or services).

115. In addition, there is precedent for similar levies not being subject to GST, the infrastructure payment made by beneficiaries in the Milldale transaction (undertaken by CIP) was confirmed by IRD as not being subject to GST.

116. In comparison rates are subject to GST, most ratepayers are not registered for GST and therefore cannot claim the GST back. Accordingly, if the Levy does not attract GST and the SPV is able to claim GST on costs incurred, there will be a benefit to the beneficiaries compared to general rates. However, this will have a negative impact on Crown revenue assuming the projects would have otherwise been delivered by local authorities and funded by rates.

117. The other potential risk created by the Levy not being subject to GST is that it could ignite debate as to whether GST continue to be collected on general local authority rates.

118. We will be seeking a binding ruling from IRD to confirm the position.

Whether the SPV is carrying out a taxable activity

119. In order to claim GST on costs incurred, a SPV will need to have a taxable activity for GST purposes. This will depend on the specific structure of the SPV and we will be testing possible structures with the IRD.

Section 8: Risks

120. In this section we outline the risks associated with implementing the Model. We have ordered these risks according to:

    a. first order risks – these are risks which are fundamental to the Model working; and

    b. second order risks – these are risks that go to how successful the Model will be and how widely it will be used (Appendix C).

121. All risks will be monitored and, where necessary, mitigations will be put in place to help manage these.

First order risks

Level of Support required by Central Government

122. To enable the Model, the Crown will be taking on certain decisions rights and risks that currently sit with the local authority. This creates the following risks:

    a. The Crown will provide cover for residual risks if they are arise (via a GSP). The risks associated with the GSP and management of these risks are summarised in Section 7 above and in Appendix D (SPV failure scenarios).

    b. Due to the level of control that Crown has over the SPV (design of the SPV, approval of the Levy), pursuant to the relevant accounting standard, the assets and liabilities of the SPV will consolidate onto the Crown balance sheet. This should not result in additional net liabilities as the assets and liabilities will offset.

    c. Ownership of the SPV remains with the Crown and doesn't evolve over time.

    d. Lobbying of the Crown by beneficiaries because final decision rights regarding the granting of the Levy sit with the Crown.

    e. Because of the greater decision rights of the Crown and Crown ownership of the SPV, it may give rise to a general expectation (above the Crown's agreed obligations) that the Crown will provide direct financial assistance if the infrastructure project fails before completion (over and above any GSP risks that the Crown might bear) or after completion (which is when the local authority assumes responsibility for the assets).

123. To manage these risks we propose that in any communication about the Model, the Crown be clear that;

    a. its role in providing the Model is to support local authorities by removing a road-block but that otherwise local authorities remain responsible for the delivery of local infrastructure;

    b. ownership of the SPV may change over time and the Crown is interested in exploring different ownership structures with local authorities; and

    c. local authorities are still involved in the process to agree the Levy (by supporting the use of the Levy and accepting the assets at the end of construction) and that this Model is a partnership between the Crown and local authorities.

Consumer/beneficiary protections

124. Some SPV's may have monopoly like features in specific local markets. This raises a question about whether they should be subject to regulation by an independent regulator such as the Commerce Commission. Where there is private ownership of some other natural monopoly assets such as electricity lines or airports, the Commerce Act 1986 has been amended to allow specific regulation of the charges of those companies with oversight by the Commerce Commission.

125. However, extending the Commerce Act to regulate the SPVs is not recommended due to the fact that Levies under the Model will already be directly regulated under legislation, and due to the time and costs involved.

126. Instead officials propose that the Levy setting process (in particular the OIC) include a number of safeguards to replicate the regulatory regime for utilities and therefore provide consumer protections. These include:

   a. local authority involvement in the Levy setting process to ensure that the Levy is affordable in the context of rates;

   b. Cabinet Approval (including the Minister of Commerce and Consumer Affairs) – who will want to satisfy themselves before approving a Levy that there is no monopoly pricing and that the costs that beneficiaries face are affordable;

   c. the OIC regulating both how much the SPV spends on projects but also the types of expenditure which are levied on beneficiaries;

   d. the Facilitator and Recommender being a Crown appointed body – part of their role will be to ensure that there are contestable processes for key cost elements of infrastructure projects;

   e. the Treasury will consult with the Commerce Commission and Ministry of Business Innovation and Employment on the development of guidance for the Facilitator and Recommender to guard against monopoly pricing and ensure beneficiaries interests are protected;

   f. the SPV will be monitored by a Crown appointed body to ensure that it complies with the OIC with respect to the setting of the Levies (therefore Commerce Commission oversight is not required); and

   g. in cases where the maximum possible Levy is not specified at the time that the OIC is approved, Cabinet will have the opportunity to specify any additional monitoring or oversight arrangements to ensure beneficiaries/consumer protections are appropriate.

127. Notwithstanding the above, there is a risk that a Levy payer could complain to the Commerce Commission, and given the possible natural monopoly nature of IFF projects, the Commission could decide to launch a Part 4 inquiry that recommends that the Minister of Commerce and Consumer Affairs impose economic regulation via OIC. Whilst both MBIE and our legal advisors consider the risk of this occurring is small, it is a non-trivial risk that Ministers should be aware of, particularly given the range of projects that are proposed to use the Model.

Local authorities' willingness to use the Levy

128. The future behaviour of local authorities towards using the Model will govern its ultimate success. We have taken steps to involve local authorities in the development of the Model, including:

   a. regular dialogue with high growth councils in relation to the Model;

   b. a series of workshops with officials from high growth councils to walk through our policy development proposals and solicit their feedback;

   c. engagement with officers of high growth councils to assess how the Model will work in practice with reference to actual projects; and

   d. Ministerial engagement with elected local authority members.

129. However, local authorities may be slow or reluctant to adopt the Model (although we note funding pressures in Auckland in particular are now more acute). Issues that have been identified which may impact the willingness of local authorities to adopt the new model include:

a. Perceived loss of control of local authority responsibilities;

b. Concern over the affordability/uncertainty of the Levy for beneficiaries;

c. Concern over the ultimate owner of the SPV – high growth councils have indicated that they want the SPV to be owned by the Crown;

d. Difficulty adapting to using the Model; and

e. Objection to the project itself (i.e. a local authority may prefer urban growth to occur first in areas other than where a Levy is proposed).

130. We propose to mitigate these risks by seeking input from local authorities at two stages in the process of developing a funding proposal. This involvement will provide local authorities with the opportunity to indicate any concerns, and provide Ministers with visibility over the nature of any concerns to inform their decision making process.

Rating agency decisions

131. The assessment of the Model by credit rating agencies' is critical to the success of the Model. [34]
[34]

132. [34]

133. [34]

134. If there is a fundamental change in the approach taken by the credit rating agencies' in relation to related obligations for government related entities then this could undermine the Model. We note that any proposed changes will be well signposted and consulted on [34]
[37]

135. If there are any potential changes to the methodology used by rating agencies' that would impact on the Model, officials will advise Ministers.

Second order risks

136. Summarised below are the risks that impact how successful the model will be and how widely it will be used. The risks are listed below and discussed further in Appendix C:

    a. Unwilling beneficiaries

    b. Development may be incentivised away from brownfields

    c. Beneficiary allocation choices

    d. Affordability and acceptability of the Levy

    e. Equity issues with the use of the Model

    f. Ability for the Levy to cover the full cost of the infrastructure

    g. Use of the Model may place pressure on funders of complementary infrastructure

    h. Powers given to a third party

    i. Communication with local authorities and beneficiaries

    j. New Legislation

Section 9: Next steps

Timing

137. We have developed a draft timeline for the consideration of policy and legislative issues, Cabinet paper and potential introduction of legislation, see below.

Date	Activity
April	Ministers to consider Draft Cabinet paper and RIS
April	Cabinet paper and RIS lodged with Cabinet Office
May	Cabinet paper and RIS considered at the Cabinet Economic Development Committee
May	Cabinet to ratify or consider the Cabinet paper and RIS
May	PCO to receive drafting instructions for the legislation
Second half of 2019	Bill introduced into the house

Appendix A: Possible projects for the Model

[37]

Appendix B: Proposed Levy Regime

Proposed Levy Regime	
Feature	**Proposed approach**
Levy commencement and length	Legislation enables the start of the Levy period and length of the Levy, to be determined on a project-by-project basis, but that the maximum length of the term be 50 years.
Prepayment of Levies	Legislation will not provide for prepayment of Levies as this would add complexity and undermine predictability of cashflows, impacting finance.
Costs funded by the Levy	Legislation enables the Levy to fund the following categories of costs: • **Construction costs** including direct construction costs, insurance and project contingency costs. • **Project establishment costs** of the proposer, facilitator (where these are directly attributable to a specific project funded by the Levy), bidders and SPV owner, with limitations governing eligibility set out in facilitator guidance material. • **SPV operating costs** including management and administration costs. • **Construction, project establishment and SPV operating costs** that have been incurred by another party and which the SPV is liable to fund or reimburse (e.g. if the SPV did not construct the assets or took over the construction of assets from a local authority and used Levy revenue to repay local authority debt). • **Asset** operating and maintenance costs prior to vesting. • **Financing costs** including debt interest costs, equity costs (where relevant), arrangement, commitment and agency fees, reserve accounts and enforcement / intervention costs. • **Enforcement** and intervention costs. • **Levy collection costs** most of which will be paid to a local authority to collect the Levy. • **SPV monitoring** costs. • [38]
Ability to vary the Levy	The Levy may under some circumstances vary over the term of the Levy period. There are three options for the variability of the Levy: • Levy does not vary – the Levy is set at a maximum levy amount. In this circumstance the beneficiary knows the maximum possible levy, however, the SPV does not have flexibility to access additional Levy revenue if it is required. • Levy can be varied – up to a maximum specified amount. The SPV would have the power to increase the Levy from the initial amount if certain risks eventuated (e.g. construction costs increased) up to a maximum amount. In this circumstance beneficiaries would know the maximum possible Levy and this would give the SPV flexibility to access additional Levy revenue under certain circumstances if it is required. • Levy can be varied and there is no maximum specified Levy. The SPV would have the power to vary the Levy under certain circumstances – but the Levy has no upper or maximum limit. This option results in the least certainty for beneficiaries but provides the maximum flexibility for the SPV in the event costs vary. In all circumstances the Levy could reduce (e.g. in the event of over-collection and the Levy is rebated). Choices about whether the Levy can be varied do not need to be made now but will be made at the time the OIC is approved, and in conjunction with decisions about the scale and scope of the GSP.
Excess charging regime (in the event the Levies are more than required to complete the project)	Legislation will include a framework for how excess Levies be used. In summary, in most cases there will be a reduction in future Levies, but potentially there could be refunds or a shortened Levy term. Specific requirements for any project will be included in the OIC.

Proposed Levy Regime	
Feature	**Proposed approach**
Identification of beneficiaries	The legislation enable a permissive approach for land-based Levies to identify beneficiaries of project depending on various factors, such as: • Geographical land area • Use of land • Activities permitted on land • Value of the land Beneficiaries in future urban zone land are anticipated to be included in the Levy. However, second wave beneficiaries (located outside the anticipated future urban zone) are anticipated to be excluded from the Levy on the basis that they will not substantially benefit from the infrastructure.
Exemptions, postponement or remission of Levy	The legislation include provision for exemptions, postponements and remissions in the same way as currently applies for rates.
Invoicing and collection of Levy	Legislation to include provision for the SPV to directly invoice and collect the Levy or to contract with the relevant local authority. Legislation will include 1) the ability for the SPV to access the rating information database and overrides of the Privacy Act (for purposes of collection) and 2) a requirement for the relevant local authority to act as collection agent where required by the SPV.
Priority of Levy	Legislation to enable Levies to be second-ranking (after local authority rates, and before all mortgages, encumbrances etc).
Enforcement	Legislation to enable the SPV to hold all legislative rights to enforce revenue in the same way a local authority can. This includes the right to sue payor's mortgagee for debt and right to require a forced land sale (after statutory timeframes have elapsed).
Security over Levy	Legislation to enable the SPV to grant security over its Levy rights, and for a receiver to be appointed to, and administer, those rights. This will be necessary in order for the SPV to raise finance on the strength of the Levy, as anticipated under the Model. These provisions would be based on similar provisions in respect of rates in the LGA, but (unlike under the LGA) they would not permit a receiver to set a new rate.
Objections	Legislation to outline an objection regime for objections from beneficiaries on how the Levy has been calculated, but not the Levy itself.

Appendix C: Second Order risks

Unwilling beneficiaries

1. The Model will enable the power to levy residents who have not opted-in to a project area. In some cases this will include unwilling beneficiaries. Mitigation of this risk is challenging, as there are many variables that lead to a beneficiary being unwilling.

2. In a greenfield development scenario the risk of unwilling beneficiaries is more remote as purchasers and developers will likely be fully aware of, and are able to 'opt-in', to the Levy. This risk is higher in instances where brownfield development is funded and financed via the Model due to the impost of the Levy on existing residents. Wilful non-payment may occur with consequential costly recovery actions needed.

3. Under certain circumstances (e.g. land banking) the Model may assist in breaking the impasse due to the cash impact of the Levy. However, it may also impact on those who are unable to afford the Levy (such as people on fixed incomes). Beneficiary identification, equity and affordability will be important considerations in the Levy design process which will help mitigate this risk. For example for existing residents, the Levy could be phased in or only become payable after a certain period of time or event (such as the sale of the house).

Development may be incentivised away from brownfields

4. As the Model will be more easily applied to greenfield projects (due to the greater simplicity of identifying beneficiaries and those who opt-in) it may encourage development away from brownfield areas. This may have environmental impacts and also work against the governments wider urban development objectives. This risk will be mitigated through implementation of the wider UGA work programme which focuses on improving spatial practices and addressing constraints to intensification.

Beneficiary identification and allocation choices

5. The accurate and fair allocation of costs in brownfield and greenfield areas may be challenging, particularly where a project funded by the Levy has network impacts or where there are existing residents and second wave beneficiaries. This is not a new issue with current methods of recovering costs, such as development contributions, consistently under recovering actual cost. The Model will provide greater transparency of infrastructure cost but beneficiary identification and allocation is still likely to be contentious. We will work with other government agencies and local authorities to develop guidance.

Affordability and acceptability of the Levy

6. There is a risk that the Levy is unaffordable either in the context of total rates payable, or on an individual basis. If the Levy is not affordable it may lead to non-payment by beneficiaries and pose a risk to the project more generally. This risk is being addressed through the disclosure regime and by affordability being one of the considerations for Cabinet when approving the use of the Levy.

Equity issues with the use of the Model

7. There is a risk that local authorities primarily use the Model in areas where the resident community are less likely to seek to challenge the Levy and/or apply pressure on local politicians. If this occurs, it could mean that areas with a greater proportion of renters and affordable housing are most significantly impacted by the Levy.

8. These equity risks are matters that the Facilitator and Recommender will need to closely monitor and further advice will be provided to Ministers if required.

Ability for the Levy to cover the full cost of the infrastructure

9. In some cases, it may be unaffordable for beneficiaries to cover the full cost of the infrastructure. Or it may be inappropriate for the beneficiaries to cover the full costs because there are wider community benefits. In these cases a contribution from the local authority[10] or other related party (e.g. NZTA) might be required deliver the projects.

Use of the Model may place pressure on funders of complementary infrastructure

10. If successful, the use of the Model will accelerate the delivery of infrastructure projects and may require complementary projects to be funded sooner than envisaged (e.g. transport projects). There is a risk that if these complementary projects are not funded, it will hold back the delivery of viable infrastructure projects.

11. Addressing this risk will rely on the ability of government agencies responsible for infrastructure, such as transport, to be adaptive and to be involved in the feasibility stage of proposals to identify and mitigate these risks. The work under the spatial and urban planning pillars of the UGA should help to deal with these issues as a more integrated approach is taken to planning, to identify and agree all infrastructure that is needed to develop a certain area.

Powers to be given to a third party

12. The power to Levy will be given to an SPV which may be owned privately or have a level of private capital. Whilst there are safeguards around the Levy and what the Levy can be used for, this could still be controversial. In most cases the SPV will only own the asset during construction, the asset will vest back to the local authority immediately after construction.

Communication with local authorities and beneficiaries

13. The Levy and use of an SPV could be misinterpreted by the public, beneficiaries, local authorities or the media. Unfavourable public commentary on the Levy could lead to non-payment. To manage this risk Treasury will prepare a communications plan for any announcements about the introduction of legislation and will work with your offices to arrange briefings of key stakeholders in advance of any announcements.

14. Additionally, the complexity of the Model may undermine uptake from developers and local government, and requires sophisticated understanding from political decision makers, officials, developers and consumers. Transparent and clear supporting material will be developed to avoid misconceptions and assumptions and increase the likelihood of uptake.

New Legislation

15. There are inherent risks with implementing new legislation and ensuring that it works as envisaged, particularly when working to compressed timeframes. We have sought to mitigate this risk through engagement and consultation with local authorities and other key stakeholders who will use the Model (financiers, developers and contractors). Officials have also been supported by Crown Infrastructure Partners, legal, commercial and capital market advisors.

[10] Which be funded by general rates or future development contributions.

Appendix D: Failure Scenarios

We have, in this section, set out various “problem” scenarios and how those scenarios would play out in practice.

For this purpose, we have assumed the following facts:

- a single SPV (owned by the Crown) is established to fund, construct and deliver network infrastructure for a new greenfields development;
- the SPV is empowered under an OIC to levy rating units within the boundaries of the development;
- the Levy is a 35 year uniform Levy which commences on day 1 of the project (with developer landowners paying the Levy initially), and provides for fixed increases over a set 4 year ramp period;
- the SPV has raised debt finance from a bank syndicate, including a contingency facility;
- a fixed price contract (with some exclusions) has been entered into with a contractor;
- the Crown has provided a GSP that provides support [38]
  [38]
- the SPV has entered into a vesting agreement under which the network infrastructure will vest in a local authority;
- the Levy has been modelled to provide sufficient headroom to enable the SPV to call on, and repay, the contingency facility if needed but (in order to have a finite cap on the Levies payable by beneficiaries) [38]
  [38] and
- in exchange for the GSP, the Crown is given a suite of step-in and other control rights in respect of the SPV and the project that are exercisable in agreed events (including if it becomes likely that the Crown will need to make a payment under the GSP).

Against that factual background, the problem scenarios we have considered are:

1. there are significant cost overruns during the construction phase;
2. the project ceases to be viable during the construction phase (such that the infrastructure cannot be delivered);
3. the SPV incurs significant financial difficulty during the post-construction (financing) phase; and
4. the infrastructure assets fail during the post-construction (financing) phase.

We have also considered, in each case, what would happen in these scenarios in the status quo (i.e. for a project that is funded and delivered by a local authority itself).

Problem Scenario 1 – cost overrun during construction phase

Under this scenario, a major issue arises during the construction phase that leads to increased construction costs.

The SPV will be able to draw on the contingency facility to finance those costs, and can repay the additional drawings from the Levy revenue (without having to increase the Levy).

However, further issues during the construction phase then occur and it appears likely that these will lead to a further increase in the construction costs. [38]
[38]

[38]

By comparison, under the status quo, any cost overrun would be borne by the local authority itself (without any Crown support) and in some way passed on to the community (e.g. through general rates).

Problem Scenario 2 – project ceases to be viable during construction phase

Under this scenario, a major issue arises during the construction phase that means that the commencement (or continuation) of construction is no longer viable. This may for instance be due to a change in law, a challenged consent or a major economic downturn.

As the project is no longer viable, the Levy should not be continued for the full term. The “excess Levies” regime proposed for the Act should operate to limit the amount of revenue that can be collected (or at least require the SPV to rebate any amount that is not applied towards eligible costs). However, this may still involve the Levy continuing for some time. In order to bring about the cancellation of the Levy, either:

1. the SPV could make a request to the Crown (with the consent of all requisite parties, e.g. financiers) that the Levy is cancelled – in this event the Crown could then cancel the Levy [38]

2. (if no such request is forthcoming) the Crown could elect to cancel the Levy – [38] [38]

[38]

[38] It is conceivable that the Crown could defer cancelling the Levy until such time as sufficient Levy revenue has accrued to cover the applicable costs [38] [38] however this would involve the beneficiaries paying an amount towards a project that is not delivered.

By comparison, under the status quo, if a project ceased to be viable any project costs already incurred (and any break costs), would be borne by a local authority and in some way passed on to the community (e.g. through general rates).

Problem Scenario 3 – SPV in financial difficulty post-construction phase

Under this scenario, the construction phase is complete, the infrastructure has vested in the local authority and is operational and working, however a significant group of beneficiaries simply refuse to pay the Levies.

This risk primarily falls on the SPV and its financiers. The SPV would be entitled to exercise the proposed enforcement rights under the Act (which include suing the beneficiaries for payment, claim payment against the beneficiaries’ mortgagees, and commencing forced sale processes). Those rights should ultimately see the SPV collect the relevant payments. However, the timing issue (delayed payments) may result in the SPV being unable to service its debt in the meantime, and the appointment of a receiver to the SPV. The receiver will then be able to exercise the SPV’s rights to compel payment.

There is however a risk that the group of beneficiaries put pressure on the Crown to intervene (particularly if forced sales become necessary) - possibly on the basis that the Crown enabled the structure and was the owner of the SPV.

By comparison, under the status quo, ratepayers might refuse to pay rates to a local authority where they oppose the project or the costs being imposed on them (as in the Kaipara example), and a local authority might need to take enforcement action itself to recover them. However rates non-payment might be considered to be less likely as rates are not specific to a project.

Problem Scenario 4 – infrastructure failure during post-construction phase

Under this scenario, after the construction phase is complete and the infrastructure has vested in the local authority, the infrastructure fails.

As the assets have already vested in the local authority, this will be borne by the local authority. Upon vesting, it will be expected that any contractor warranties will have been assigned to the local authority and accordingly the local authority will be able to exercise any relevant warranty rights. The local authority may also hold insurance for the relevant event.

Neither the SPV, nor the Crown (under the GSP), will have any continuing liability for the assets post-vesting. The Levies will continue to be payable to the SPV notwithstanding the infrastructure failure.

The same result would apply under the status quo (that is, infrastructure failure is the local authority's risk).