

The Treasury

Budget 2022 Information Release

August 2022

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- [38] 9(2)(j) - to enable the Crown to negotiate without disadvantage or prejudice
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Treasury Report: Budget 2022 - Advice on Health Capital Investments

Date:	4 March 2022	Report No:	T2022/286
		File Number:	SH-1-8

Action sought

	Action sought	Deadline
Hon Grant Robertson Minister of Finance	Signal your preferred health capital package for Budget 2022	7 March 2022

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Helen Anderson	Senior Analyst, Health [39]	N/A (mob)	
Sebastian Doelle	Team Leader, Health	N/A (mob)	✓

Minister's Office actions

Return the signed report to Treasury.

Note any feedback on the quality of the report

Enclosure: No

Executive Summary

The Minister of Health seeks an increase of [33] billion capital to the Health Capital Envelope appropriation as part of Budget 2022. The proposed funding is intended to cover health capital costs for the next two financial years until the full New Zealand Health Plan in 2024. Consistent with the rest of the Vote Health, we are not expecting capital funding requests in Budget 2023. The funding sought is for five areas of investment:

- [33]
-
- Partial funding for Nelson Hospital Redevelopment, [33]
- [33]
-

The proposed package for health capital would [33] the redevelopment of Whangarei Hospital (\$572 million which joint Ministers have previously prioritised, plus [33] [T2021/1739 refers]), but only partially fund Nelson Hospital [33] million of the estimated total costs of [33]. The Detailed Business Cases for both projects are expected to be submitted to Joint Ministers for investment decisions in Q2 2022.

The Ministry of Health has also identified projects totalling [33] where there is a high need for investment and where projects require approval and funding before Budget 2024. [33]

The Treasury has developed two alternative packages for health capital in Budget 2022. [33]

We recommend Ministers to agree to this package.

[33]

The second alternative package would require [33] capital over the next two financial years. This package defers until Budget 2024 all projects in an early stage of development. These projects have yet to deliver an investment ready business case and are likely to require further planning, design and/or scoping work. It also requires Health New Zealand to cover unknown risks and urgent remediation projects within baselines.

Considering constraints in the construction sector, fiscal constraints and limited health sector planning capability, the Treasury recommends that any new significant investments in infrastructure projects (other than Nelson and Whangarei Hospital Redevelopments) are deferred until Budget 2024.

The Treasury supports the Health Infrastructure Unit's current reviews of further risk mitigation and value management options of major projects in order to provide additional headroom for risk mitigation and cost escalation. [33]

The Ministry of Health, Department of Prime Minister and Cabinet and the Treasury, with support from the Infrastructure Commission, have developed options for the future capital system settings. These are outlined in a separate Joint Report (TR2022/425 refers).

Recommended Action

We recommend that you:

- a **note** the Treasury's recommended package of [33] health capital investment in Budget 2022 covers cost pressures across the existing infrastructure portfolio and allows investment in a small number of key infrastructure projects over the next two financial years
- b **note** the Treasury's minimum package of [33] defers relatively lower priority and uncommitted projects to future Budgets and seeks HNZ to manage remediation projects from within its uplifted baselines with no provisions for risk contingencies
- c **signal** your preferred package for health capital investments in Budget 2022 which is subject of your discussion with the Minister of Health on 7 March 2022
- d **note** that delegation and governance arrangements for project specific investment decisions for health capital are subject of the Joint Report – *Health Capital Settings – recommendations for Cabinet paper* (TR2022/425 refers)



Sebastian Doelle
Team Leader – Health & ACC

Hon Grant Robertson
Minister of Finance

Treasury Report: Budget 2022 - Advice on Health Capital Investments

Purpose of Report

1. This report provides advice on health capital investments in Budget 2022 to support your discussion with the Minister of Health on 7 March 2022.

Background

2. The Minister of Health has submitted a Budget 2022 initiative seeking a [331] increase in the *Health Capital Envelope* multi-year appropriation (HCE) in order to fund investments in the health infrastructure portfolio over the next two years.
3. As part of the health sector reforms, Cabinet has agreed to a multi-year funding approach for operating funding for health services and expenses from Budget 2024 onwards (SWC-21-Min-0157 refers), with a transitional two-year arrangement at Budget 2022. In order to align investment decisions for both operating and capital in Budget 2022, the Ministry of Health is seeking an increase of [331] capital for the next two financial years, with funding beyond that to be determined in the lead up to Budget 2024 in the context of a full New Zealand Health Plan.
4. The proposed top-up of the Health Capital Envelope (HCE) of [331] capital builds on the \$3.950 billion in Crown capital funding provided via the HCE for infrastructure projects in the last four Budgets, as well as [331] for the New Dunedin Hospital project, and \$300 million for the health infrastructure programme in January 2020.
5. In support of the initiative seeking [331] for Budget 2022, the Ministry of Health has conducted two system wide screening processes, namely:
 - Capital needs as signalled in the Capital Intentions process by DHBs (HR20212583 refers)
 - Cost pressure analysis of projects managed by the Ministry's Health Infrastructure Unit (HR20220071 refers)
6. In order to reflect competing pressures for Crown funding, timing of planning processes, and construction capacity and capability to deliver, the Ministry of Health has ranked the submitted projects based on clinical need and state of existing assets. The [331] requested reflects the outcome of this exercise.

Capital intentions of the health sector significantly exceed available funding

7. As part of the capital intentions process, DHBs have signalled capital investment needs [331]. The ten-year capital requirements of approximately [331] are a significant increase from the [331] indicated in the DHB's submissions in 2020. For Budget 2022, [331]. The increase is likely to reflect both an increase in need, and DHBs providing much better visibility to the Ministry of Health of self-funded projects.

8. Generally, the data on capital intentions received from DHBs changes frequently, is of variable quality and has a short-term bias. There is also a lack of realism about planning and delivery timeframes for many projects. Asset age and condition is a major issue across the sector but the extent is yet to be fully surfaced. Demographic growth is also driving demand for new infrastructure capacity.
9. HNZ will need to work through a process to plan and prioritise capital investments in order to meet future infrastructure demands, as well as develop asset management and national investment management plans to feed into the New Zealand Health Plan in 2024. This will include looking at models of care to ensure that investment in built infrastructure is the best way to achieve the relevant health outcomes, and that it is appropriately planned nationwide to make the best use of scarce resources.

Cost pressures - overview

10. The Ministry of Health has signalled cost pressures against the current portfolio of health infrastructure initiatives of over ^[33] based on recent and rapid increase in the construction market cost escalation due to domestic demand, supply chain disruptions, commodity price increases and labour shortages (see Appendix 1 for a list of the cost pressures).
11. The projects which contribute the most to the overall cost pressures are ^[33]

The Ministry is conducting value management reviews across a number of key projects

12. ^[33]

13.

14.

15.

Should project specific contingencies be utilised to mitigate cost pressures?

16. The Ministry of Health advises that, on average, approximately [33]

While [33] is relatively robust, each project will have differing risk profiles given project type, location and market conditions at the point in time in which market pricing is sought.

17. Given these factors at play, along with market pressures identified earlier in this report we agree with the Ministry's recommendation that these project specific contingencies are not utilised for budget adjustments.

Funding for projects with outstanding investment decisions by Joint Ministers

18. Joint Ministers have previously signalled that they expect Budget 2022 to include capital funding for the Nelson and Whangarei hospital redevelopments. Investment decisions for Nelson and Whangarei hospitals are expected to be submitted to Joint Ministers in Q2 2022.

19. The Ministry of Health has sought only [33] for design and enabling works for the Nelson Hospital project, while seeking [33] in order to fully fund Whangarei Hospital. Decoupling investment decisions from funding decisions creates risks of uncertainties for the project owner, and future budget pressures. While we support a phased approach so that the decision on whether/how to proceed with an investment is informed by robust information – i.e. investing in the next phase of projects (i.e. development, design, delivery), we recommend that funding should be allocated for projects at the same time as Ministers make investment decisions.

20. [33]

Ministers have choices on how much funding is being provided for these projects and in which areas these investments should go, as these projects are in an early stage of development and require further planning, design and/or scoping work.

Treasury's recommended package

21. The Treasury broadly supports the budget initiative for a significant HCE top up. However, the various elements within the initiative need to be considered in light of construction sector capacity, fiscal constraints and health planning capability.
22. Given the low level of planning maturity for capital projects in the health sector, we recommend prioritising cost pressures for the existing health infrastructure portfolio before committing funding towards projects at a relatively early stage in development. These could be deferred until Budget 2024.
23. The Treasury's recommended package of [33] would allow investments of [33] to fully fund in the Nelson Hospital Redevelopment (to which no funding is currently allocated within the HCE) and an additional [33] to fully fund the Whangarei Hospital Redevelopment project (for which \$572 million is indicatively

prioritised within the HCE). [33]

24. The Treasury recognises the case for a contingency in order for HNZ to meet unforeseeable increases in project costs and address urgent projects as they may arise over the next two financial years. However, given the significant known cost pressures across the capital portfolio, [33]
25. The Treasury's minimum package reduces the overall funding provided in Budget 2022 to [33]. It does this by:
 - a Deferring until Budget 2024 all projects in an early stage of development. These projects have yet to deliver an investment ready business case and are likely to require further planning, design and/or scoping work.
 - b Requiring Health New Zealand to cover unknown risks and urgent remediation projects within baselines, with no risk contingency.
26. This package increases the risk of unforeseen cost pressures being passed on to HNZ's baselines, which could create unsustainable pressure for HNZ. [34]

Timing of addressing cost pressures in the existing health portfolio is critical

27. Decisions on additional funding for the HCE are time sensitive, as many of the projects facing cost pressures are expected to engage with the construction market for main contractor negotiations, [33]
28. The Treasury supports the funding of cost pressure as part of Budget 2022 funding decisions. Deferring funding decisions for cost pressures across the existing health infrastructure portfolio will likely lead to delays in project delivery and funding uncertainty for the health sector.

Health Envelope Options	Capital -	Ministry of Health's preferred package	Treasury's recommended package	Treasury's alternative minimum package	Treasury comments
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[33]

Nelson Hospital Redevelopment	[33]				<p>Funding and investment decisions should be made together. Deferring funding decisions while committing to the overall project investments creates future budget pressures and pre-commitments.</p> <p>[33]</p>
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[33]

[33]

Annex 1: Budget 22 Update - review of Health New Zealand's initial draft budget and implications for final Budget funding decisions

Purpose

1. This paper updates Ministers on the Ministry of Health and the Treasury's preliminary review of interim Health New Zealand's (HNZ's) initial draft budget (including Crown Monitors' views) with a focus on setting out implications for final Budget 2022 decisions ahead of Budget Ministers 6 on 1 April 2022. It seeks decisions from you to inform our drafting of financial recommendations for the Budget 2022 Cabinet Paper over the next week. Our advice in this paper is consistent with funding at the upper end of the communicated planning parameters and identifies options for managing known costs as well as residual risk.
2. There is considerable uncertainty about the non-discretionary costs of running the health system in the next two years, with potential for both upside and downside surprises. [33], [34]
[33] [34] . Given this, **we recommend to Ministers that**, rather than appropriating the full quantum of proposed cost pressure [33] and rebase [33] funding on Budget day, you instead initially announce a portion of the funding in a four-year operating contingency, for draw-down ahead of Day One and throughout 2022/23. This will signal your commitment to fully funding the new system, while also indicating your expectation that HNZ will take a strategic approach to allocation of funding across units, and pursue all available savings and efficiencies throughout the transitional period in order to see maximum investment in BAU activity line with reform objectives.
3. This paper also outlines next steps on the Ministry of Health's scrutiny process between final Budget decisions and Day One.

Assessment of Health NZ initial budget as at 24 March 2022

4. [33]
[33] [34] This upper end has been factored into the HNZ budget consolidation and initial draft, which was shared with the Ministry and the Treasury on 14 March 2022 and is still in the process of refinement. It will be presented to the HNZ Board on 25 March 2022, with further work to progress following this. We are having further conversations with Crown Monitors on Sunday 27 March 2022. A summary of HNZ's current budget is included at the end of this paper.
5. Based on the signalled increase in revenue and HNZ's understanding of Vote Health appropriations following the March Baseline Update, the initial draft budget [33]
[33] [34] The HNZ finance team has indicated potential savings of around [33] that may be possible to achieve at this level of funding, which could be used to manage the deficit.
6. HNZ has to date only been able to have one review session with each DHB on their submitted information. Significant further analysis is needed to refine this initial consolidation exercise as part of the HNZ planning process for 2022/23.

Material financial risks will remain.

7. [33], [34]

[38]

8. [38]

9. The budget consolidation work takes as its starting position the sector's planned budget for the 2021/22 financial year, rather than its year-to-date actual performance or current year-end forecasts. There is material in-year variation from plan due to both changes in BAU activity, as well as considerable COVID-19 funding and activity, with current forecasts for revenue and expenditure up \$1.3 billion and \$1.2 billion on plan respectively, with a small positive impact on the forecast net result. Given the difficulty of determining the BAU position in the current environment, HNZ's choice to work from the planned budget is reasonable; however, not taking the in-year variation into account creates risk in terms of assessing the right starting position for HNZ in 2022/23. While the Ministry remains of the view that [33] is a sensible amount for the rebase, there remains a risk that the deficit position will deteriorate over the remaining months of the financial year and exceed this amount.¹ The February DHB sector flash report (Annex 6) provides more detailed analysis.
10. There is also the risk of general inflationary pressure across all of health operating and capital costs. However, this applies across government more generally and is reflected in government-wide specific fiscal risks (SFRs).

There is opportunity for efficiencies and rationalisation over the first two years.

11. Agencies jointly requested the views of Crown Monitors on the initial budget position given their familiarity with and expertise on DHB financial planning. While highlighting the lack of information currently available, Crown Monitors considered that there is likely to be opportunities for savings and/or reprioritisation beyond the initial [33] identified by HNZ, requiring further exploration. Concerns raised to date include:

- [33], [34]

The Crown Monitors

applauded the effort to consolidate DHB information and ensure 20 units are on the same system. They consider HNZ now needs to look to drive value in its budget and consider how the uplifts in revenue should be allocated across the system to support system sustainability, and to begin eliminating variation and supporting improved productivity. There will be limits about how much can happen ahead of Day 1 and so the design of HNZ's operating model and organisational structures and processes will be critical to ensure a strong performance management framework and function drives a systematic approach to identifying opportunities to reduce variation, increase efficiency and improve performance.

- [33], [34]

¹ The risk of deterioration will be recognised in a specific fiscal risk (SFR) for publication in the Budget Economic and Fiscal Update (BEFU) at Budget 2022.

[33]

[33]

- **Volume changes:** HNZ is not yet in a position to share the volume changes underpinning the initial draft budget for 2022/23 at the district level as it is still working through the information provided from DHB submissions. However, Crown Monitors consider it likely that DHB submissions will vary considerably and need to be tested at a national level. This work will happen through April 2022.

12. The Ministry and the Treasury also note that the draft HNZ budget builds in some extra costs relating to increased capital charge due to building revaluations. DHBs were not asked for any information on assumed revenue, and therefore it is unlikely that the initial draft budget factors in increased Crown revenue for the capital charge implications of revaluations or new capital assets coming on stream. Officials expect this could provide a further ~\$50 million in revenue to be funded from centrally held capital charge contingencies with no impact on the Crown's operating balance.

13. [33]

14. Stronger strategic analysis by HNZ of the baseline is required, including articulating the way in which additional revenue will support system transformation and performance improvement. The HNZ finance team has already indicated that further work is planned, but that it will take time. To ensure the right level of assurance can be achieved, this will rely on clear, early expectations on the future system from Ministers to the Board and senior management. These expectations will be reflected in the interim Government Policy Statement (iGPS) as well as in other key planning and accountability documents (interim New Zealand Health Plan (iNZHP), Statement of Performance Expectations).

Together these 'unders and overs' create significant uncertainty around what the revenue shortfall (if any) might be in 2022/23 and 2023/24.

Implications for Budget 2022 decisions

15. You have asked for further advice on the implications of funding Health cost pressures and rebase at the upper end of planning parameters, including remaining risk, to inform Budget Ministers 6 decisions on 1 April 2022.

16. Officials remain of the view that the health system will likely need the full \$1.8 billion as provided for at the upper end of the planning parameters, [33]

[34]

17. Given the significant uncertainty both upwards and downwards this early in the HNZ planning cycle, we are collectively keen to explore every option for savings, efficiencies and reprioritisation to get the best value out of the investment over the transitional period, and to gain more information on the materiality of the residual risk.

18. On 4 April 2022, the Ministry will submit fiscal forecasts to Treasury on behalf of HNZ and the Māori Health Authority (MHA). These forecasts will be based on HNZ and MHAs' draft budgets. We consider that, at the upper end of the planning parameters, and assuming [33], [38]

19. However, two key residual risks would remain, including that:

- [33]
- [38]

20. [34]

Acknowledging constrained Budget 22 allowances, Ministers have a number of options for how to manage this risk through final Budget decisions.

21. We outline three options for managing the risk via Budget 22 decisions, and their main benefits and disadvantages or risks, in the table overleaf. For all options, there will be SFRs and potential additional pre-commitments against Budget 23.

22. In assessing the options, we took into account the need to:

- a) send the right signals to HNZ both about Ministers' commitment to fully fund the system at the required level, and their desire for HNZ to design and implement a fiscal strategy that seeks efficiencies and performance improvements via changes to BAU;
- b) create the right mix of levers for Ministers and officials to support good quality planning and accountability documents for the first two years, via clear expectation-setting alongside support and scrutiny;
- c) communicate the selected option effectively, both to the public and HNZ; and
- d) implement the option in a way that supports high-trust engagement between all entities.

23. [33]

³ Note that this risk also exists for the MHA, but is less material.

<p>Option C (Recommended): Appropriate a proportion of the cost pressures [33] or rebase [33] in a four-year operating contingency in order to incentivise further scrutiny by HNZ, the Ministry and the Treasury over the next three months on costs and performance improvement opportunities. The contingency could be drawn down ahead of Day One and throughout 2022/23 as more analysis became available about choices and tradeoffs.</p>	<p>Sends a strong signal to HNZ about Ministers’ desire to properly fund non-discretionary and fixed health costs, while also highlighting Budget constraints, significant uncertainty about cost and delivery, and the need to seek value. Signals Ministers’ expectation that HNZ undertakes further work on its financial strategy to identify performance improvement opportunities and desirable changes to BAU activity.</p> <p>May help find further savings to reduce the risk that additional funding is required in 2022/23 and give us better information on what the remaining risk is for 2022/23.</p> <p>Will enable rephasing if that is found to be desirable to support fiscal sustainability, ie an “invest to save” approach.</p>	<p>Depending on conditions for access to contingency, could appear at odds with Minister’s commitment to fully fund the new system, and runs the risk of HNZ viewing this as a lack of trust.</p>	<p>Would need careful communication to emphasise Ministers’ continued commitment to fully fund the health system, and reiterate that the contingency is about buying time to resolve some of the uncertainty about how much funding is needed to do that.</p> <p>Would need to think about potential impact (in both logistical and signalling terms) of holding back cost pressures as opposed to holding back rebase.</p> <p>Would need to carefully manage the risks of frontloading spending in an “invest to save” approach.</p>
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24. [34]

If such a choice needs to be made, we think it is better to aim to make it closer to Day One on the basis of better information about HNZ’s budget and performance – especially as it may not need to be made at all.

Next steps

25. The Ministry is supportive of the work that HNZ is progressing and note the scale of the task to bring this work together. In recognition of the limited capacity that exists within HNZ at this point, the Ministry, the Treasury, and the Transition Unit anticipate working alongside HNZ to support them to progress strategic budget and planning related work.

26. Once the iNZHP is provided to agencies for analysis, we will be able to take more robust analysis of risk and opportunity across the HNZ budget and planned activity. As part of this work, we would anticipate providing HNZ with a list of follow-up questions and areas for further engagement including those noted above and including a requirement to undertake a systematic baseline or budget review as part of the next steps in its own budget process.
27. To support good fiscal and operational management, we anticipate working closely with HNZ and the MHA (to finalise their budget and planning intentions in advance of 1 July 2022, as set out in the table, below). The Ministry will brief you in April about how and where to best express specific planning expectations for HNZ and MHA to achieve collective clarity around what is needed and by when.

Review process	6 April	26 April	17 May (Budget day 19 May)	30 May	By 30 June
NZ health plan		First draft plan provided to the Ministry for review	Ministry feedback provided to entities	Board approved draft Health plan provided to the Ministry	Ministry advice prepared for Minister, and Ministerial response and approval of plan before 30 June
Budget information	Estimates – service performance and Budget loaded into CFIS-net	HNZ Budget and supporting information provided to Ministry for	Ministry feedback provided to entities	Draft final budget and complete analysis, including output of line-by-line review	Final budget incorporated into in Final plan/SOI and SPE
SPE and SOI (these will align to Estimates and iGPS)			Ministerial feedback on draft documents provided to entities (timeframe for feedback as per CE Act)		Board approved documents provided to the Minister SOI and SPE published on entity website

HNZ Initial Draft Budget figures as at 24 March 2022

[33]

