



2010 Investment Statement of the Government of New Zealand

Hon Bill English, Minister of Finance

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About this document

This volume contains the first *Investment Statement of the Government of New Zealand*. This document is not statutorily required, but is a new report introduced by the current Government.

Accompanying the release of the *Investment Statement of the Government of New Zealand* is a separate volume containing two documents: the Minister of Finance's *Budget Policy Statement 2011* (BPS) for the forthcoming Budget and the Treasury's *Half Year Economic and Fiscal Update 2010* (HYEFU). Both of these documents are required to be published under Part 2 of the Public Finance Act 1989 (PFA) which specifies principles of responsible fiscal management and sets out reporting requirements for the Minister of Finance and the Treasury.

Investment Statement of the Government of New Zealand

The 2010 *Investment Statement of the Government of New Zealand* provides an overview of the significant assets and liabilities on the Crown's balance sheet, how they have changed over time and how what the Crown owns and owes is forecast to change over the next five years. The main objective of the new report is to enable greater scrutiny of the Government's management of its assets and liabilities, in order to strengthen the current financial reporting framework. A second objective is to provide a regular statement of the Government's investment intentions over the medium term.

Budget Policy Statement

The reporting that the PFA requires of the Minister of Finance consists of two fiscal responsibility documents: the BPS (normally released in December) and the *Fiscal Strategy Report* (FSR) (released alongside the Budget – normally in May). The BPS must state the broad strategic priorities by which the Government will be guided in preparing the forthcoming Budget. The requirements of the BPS are to:

- state the overarching policy goals that will guide the Government's Budget decisions
- state how the Budget accords with the Government's short-term fiscal intentions
- state any changes to the Government's long-term fiscal objectives
- state any changes to the Government's short-term fiscal intentions, and
- explain how any changes in long-term fiscal objectives and short-term fiscal intentions accord with the principles of responsible fiscal management.

Half Year Economic and Fiscal Update

The HYEFU includes the Treasury's overall economic and fiscal forecasts and disclosure of fiscal risks. The PFA requires an economic and fiscal update to incorporate, to the fullest extent possible, all government decisions and other circumstances that may have a material effect on the economic and fiscal outlook.

Additional technical details about the content of the HYEFU can be found on the Treasury's website at <http://www.treasury.govt.nz/budget/forecasts/hyefu2010>

Internet

The URL for this document on the Treasury's website at 14 December 2010 is

<http://www.treasury.govt.nz/budget/2010/is>

Persistent URL: <http://purl.oclc.org/nzt/b-1343>

Foreword

I am pleased to present this first *Investment Statement of the Government of New Zealand*.

In Budget 2010, I indicated that better information about significant assets and liabilities on the Crown's balance sheet, and how well they are being managed, could form the basis of a regular statement of the Government's investment intentions over the short to medium term. This report will enable greater scrutiny of the Government's management of its assets and liabilities.

New Zealand has been a world leader in the transparency of the Government's accounts since the early 1990s, and remains one of only a few countries that prepare a sovereign balance sheet according to independent accounting standards. This transparency has a number of benefits, including contributing to our sound sovereign credit rating. But there is always room to improve.

The introduction of the *Investment Statement* to the regular suite of financial reporting documents will further strengthen this framework. It will assist our drive to help New Zealanders to get a better handle on government spending and the risks to the Crown's financial position, and on the extent to which this may be undermining or crowding out opportunities for growth-enhancing private sector investment in New Zealand.

Effective management of Crown assets, and making the best future investment decisions, is important if we are to realise our economic goals and deliver better public services.

Over the past 15 years there has been a fundamental change in the size and mix of assets and liabilities on the Crown's balance sheet, with the value of the Government's assets now more than four times the size it was in the mid-1990s and now more than double the size of borrowings and liabilities. This has led to significant growth in the Crown's net worth from around zero in the mid-1990s to around \$95 billion in 2010 (50% of Gross Domestic Product [GDP]).

These changes have materially increased the significance of the performance and management of the Crown's assets on the Government's overall financial position and long-term sustainability, as well as on the wider economy. The impact on the economy is direct in some areas, given the Government is a major player in key sectors of the economy (such as energy) and holds core parts of the national economic infrastructure (such as roads).

Better fiscal management requires us to look across the whole of the Government's assets and liabilities to ensure that our investments and risks are managed effectively. The global financial crisis and sovereign debt concerns in other countries have reinforced the need for strong public sector financial management, and for enhanced transparency and accountability around government finances.

Better balance sheet transparency and management will help us to make more informed choices about the most efficient use of domestic resources in the economy as a whole, and is therefore an important element of our overall economic agenda. A strong and stable economy in turn reduces the need for the Crown balance sheet to compensate, for example, for the low level of household savings and high external vulnerabilities.

Against this background, decisions about how to utilise Crown capital need to be carefully made, particularly as over the next few years new Crown capital funding will be borrowed and will therefore impose a financing cost on taxpayers. Much new investment will ultimately be funded by users of government services. In either case, it is essential that Government ensures that capital is both efficiently allocated and well managed.

Looking forward, there are a number of challenges and opportunities. We will need to continue to look for ways to get the best performance out of all State assets and companies, while rebuilding the strength of the Crown's balance sheet against future risks and pressures.

It is my hope that this *Investment Statement* achieves two main objectives that we can build on in future reports:

- greater transparency about the Government's management of its material assets and liabilities, and the challenges we face looking ahead, and
- an indication of the Government's high-level investment priorities for the short and medium term.

A handwritten signature in black ink, appearing to read "Bill English". The signature is fluid and cursive, with a large initial "B" and "E".

Hon Bill English
Minister of Finance

14 December 2010

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Executive Summary

This *Investment Statement of the Government of New Zealand* provides an overview of the significant assets and liabilities on the Crown's balance sheet and how they are forecast to grow over time.

The main objective of this Government in introducing the *Investment Statement* is to facilitate better understanding of what the Crown owns and owes on behalf of the public. Taking a Crown-wide investment perspective will help to ensure that Government's capital management decisions promote stronger growth and higher living standards for New Zealanders while strengthening the Crown's financial position.

The Government has two main objectives for its capital management.

The first objective is **to fund priority government services**. This encompasses delivery of both social services and core operations of the Government. Many of these assets produce largely non-financial returns. They include, among others, schools, state housing, hospitals, state highways, defence assets and conservation land. A number of these sectors are also discussed in the *National Infrastructure Plan*.

The Government's asset management objectives for these assets are to ensure that they are used productively and efficiently. This means applying sound asset management principles, such as good performance information, whole-of-life investment appraisal and an ability to redirect capital where it is most needed and produces most value.

The second objective is **prudent financial management**. The Crown must remain solvent, and ensure that any liabilities it accrues do not unduly burden future taxpayers. What matters is the size and composition of the assets on the balance sheet relative to the liabilities the Government may need to take on, and how well they are matched over time. While there will be periods, as at present, when it is appropriate to allow liabilities to increase, in the long run the Government must at least maintain its net worth in order to avoid the need for future taxation increases.

The Public Finance Act 1989 makes the expected future track of taxes, expenditure and debt transparent. But it is not just the Government's tax and operational spending decisions that influence public finances – performance of Crown assets and liabilities also matters. The Crown has substantial financial and commercial assets, all of which produce financial returns. It also has liabilities such as future pension and insurance obligations. Increasingly it has assumed contingent liabilities, such as the Retail Deposit Guarantee Scheme. Financial prudence dictates that the totality of these exposures, including taxes, expenditure, assets, debt and other liabilities, is managed in a way that supports a sound financial framework, and does not place excessive risk on the Crown or the wider economy.

The Government's balance sheet is large and is significantly stronger than 15 years ago.

Measurement of the Crown balance sheet was first introduced in 1992. Since then it has expanded steadily. As at 30 June 2010 the Government owned \$223.4 billion of assets. Net worth has increased from around zero in the mid-1990s to \$95 billion in 2010. Social, commercial and financial portfolios have all grown strongly. This has been funded from a variety of sources: investment of operating surpluses by the Crown; agency balance sheets; and retained earnings within State-Owned Enterprises (SOEs). Significant policy

decisions have driven increases in some areas; for example, the establishment of the New Zealand Superannuation Fund (NZSF) and the decision to fully fund much of Accident Compensation Corporation (ACC) liabilities.

The Crown's capital is mostly allocated to social and financial assets.

The Crown's assets consist primarily of social assets (for example, roads, schools and social housing) which make up 50% of total assets, and financial assets (27% of total assets). Commercial asset holdings are comparatively modest. The combined net value of the SOEs (excluding KiwiRail) plus the Crown's holding in Air New Zealand was \$15 billion as at 30 June 2010. This is a small fraction of social and financial assets. It is about the size of Housing New Zealand Corporation (HNZC) assets, and substantially less than the value of state highways.

The large size of the portfolio means that effective management matters.

The Crown's balance sheet plays a number of important roles in the economy, including maintaining low overall costs of capital raising through protecting or improving New Zealand's sovereign credit rating and providing the Government with financial flexibility to support the economy in times of distress. This has been seen in the response to the recent recession and events such as the Canterbury earthquake.

The cost of holding these assets is significant. Using the public sector discount rate – which is the best measure of the Crown's cost of capital taking into account both the cost of debt and risks involved in the Crown's investments – of 8%, the opportunity cost is approximately \$18 billion per year. This is equivalent to about 25% of General Government Spending (core Crown expenses) in 2010/11 and is larger than the annual government spending on health. This emphasises the need for the Government to use its capital effectively.

The Crown's assets are forecast to continue to increase significantly in the next five years.

Government's annual capital investment is substantial. Over the next five years, the forecasts show total accumulation of assets of over \$70 billion. About half of this increase will be to acquire social assets, principally roads, schools and hospitals. The balance is mostly accumulation of financial assets.

The total investment in assets will be offset by \$20.5 billion of expected depreciation, and \$14.3 billion anticipated reductions in financial assets held by the Reserve Bank of New Zealand (RBNZ) and the New Zealand Debt Management Office (NZDMO). Including all these factors, total assets are forecast to increase by \$32.9 billion over the next five years to \$256.3 billion.

Despite this, the Crown's financial position is now deteriorating and will continue to worsen further before it gets better.

The impact of the economic recession can be seen in the recent deterioration of the Crown's financial position (rising debt and declining net worth). Forecast government deficits will see the Crown's net worth continue to decline as debt grows faster than assets. Liabilities are forecast to increase by \$44.8 billion and net worth will decline by \$11.9 billion to \$83.1 billion by 2014/15, bringing net worth down to 33.6% of forecast GDP at the end of this period.

Various indicators suggest that the Crown's balance sheet can be better managed.

Asset management practices have not kept pace with the growth in the balance sheet.

While total social assets, for example, are more than twice the size they were in 1995, it is difficult to see similar levels of service improvements. Measures of the performance and efficiency of capital in most sectors is relatively weak, and whole-of-life planning and management of these assets is just emerging. In some areas there is a low level of contestability in service delivery and a history of weak procurement practices to drive better performance.

There has also been insufficient measurement and monitoring of the performance of the Government's financial and commercial portfolios. This deserves more attention, particularly given the size of the financial portfolio and the impact these portfolios have on the Crown's overall net worth. The available evidence suggests that performance of these portfolios has been mixed.

The release of this Investment Statement is a critical step for increasing transparency around balance sheet performance, and therefore for lifting that performance.

The Crown is by far New Zealand's largest owner of assets. Its very large portfolio of assets is the result of a number of individual decisions, rather than as part of a coordinated or disciplined strategy. There is scope, therefore, for better alignment of the Crown's capital investment with its objectives and priorities.

The Government's intentions for how the balance sheet will be shaped over time, and how the performance of the individual components will be improved, focus on:

- rebuilding the Crown's balance sheet buffer against future adverse events
- systematically working to reduce the Crown's risk exposures, including through strengthening the economy
- sharpening incentives on State agencies to use existing Crown capital well
- continuing to look at introducing private sector capital and disciplines where appropriate to help drive up the performance of State assets, and
- more actively reprioritising Crown capital to its highest value use.

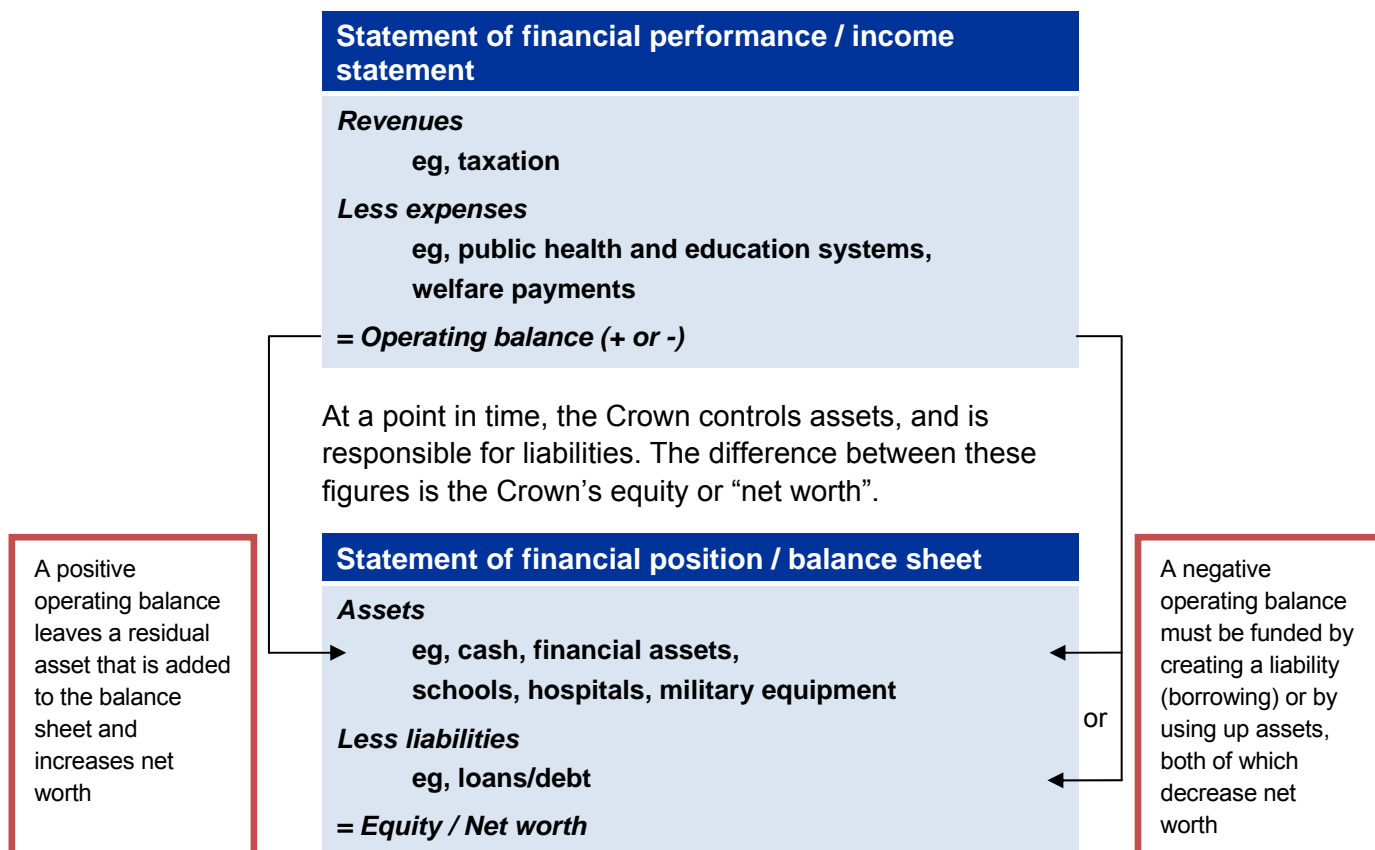
A major focus will be on ensuring that the management of the Crown's capital complements and is consistent with its efforts to raise New Zealand's potential growth rate and reduce macro-economic vulnerabilities by tilting the economy towards higher savings and exports and getting better control over government spending.

These priorities will guide the Government's future investment decisions. They will also guide the Government's continuing efforts to improve the performance of government agencies in managing the Crown's assets and liabilities to better meet the needs of current and future New Zealanders.

Relationship between spending and the balance sheet

During a year, the Crown collects revenue and incurs expenses. The difference between these figures is the “operating balance”. The operating balance is like a company’s profit/loss and can be positive or negative.

Figure 1 – Relationship between an income statement and a balance sheet



When a government purchases an asset it can fund this by reducing another asset such as cash, or by borrowing and incurring a liability. While this will not change net worth at a point in time, it changes the *composition and risk profile* of the balance sheet. For example, while “cash” and a frigate are both assets, it is not possible in the short term to use a frigate to fund a negative operating balance.

Introduction

The importance of the Crown's balance sheet

The Crown's balance sheet is a record of the assets owned, and the liabilities or obligations owed, by the Government on behalf of current and future New Zealanders. It provides a snapshot of the financial strength and sustainability of the New Zealand Government. The balance sheet should be fit for purpose in terms of its size and composition, and managed in a way that protects long-term value for taxpayers by enhancing returns and constraining the Crown's risk.

Government owns assets to achieve its social and economic policy goals, as well as to manage the liabilities and risks facing the Crown and the wider economy now and into the future.

The Government's balance sheet management will therefore reflect its decisions about:

- how best to finance, in the most efficient way, the Government's policy priorities such as delivering smarter public services, looking after the conservation estate and providing productive infrastructure
- how the Government can best support the conditions needed for a thriving economy, and
- prudent overall management of the Government's financial position, in terms of having appropriate liquidity and flexibility to meet spending commitments and liabilities in a crisis without an untimely fiscal contraction, and to support longer term fiscal sustainability.

The strength of the Crown's balance sheet is vital to the entire economy. It is critical to ensure that the Government's investment in assets does not, however, impose growth-dampening costs on the economy by, for instance, crowding out the private sector, or impose undesirable levels of risk or unnecessary costs on taxpayers.

The strength of the Crown's balance sheet was one factor that has meant that, despite already being in recession, New Zealand has been able to manage its way through the global financial crisis which has had a more significant effect on many other countries around the world. For example:

- various identified infrastructure projects, spanning the housing, transport, education and energy sectors, were able to be accelerated to stimulate economic activity

- significant (and ongoing) operating deficits were able to be quickly and efficiently funded through additional Crown debt, instead of having to rapidly cut government spending or increase taxes, and
- retail and wholesale bank and financial institution guarantees were introduced, and additional liquidity was made available through the Reserve Bank.

These actions provided a cushion for the rest of the economy – the Government was able to partly absorb the shock on its own balance sheet, thereby protecting private incomes. Without this cushion, the shock to private incomes would have been much larger.

More recently, domestic events such as weathertight homes issues, the Canterbury earthquake and the collapse of a number of finance companies have also realised a number of risks to the Crown's finances. The financial impact of these events has been manageable for the Crown because of the overall strength of the balance sheet and also because the Government had to some extent provisioned for these types of risks.

For the balance sheet to continue to provide this flexibility and resilience, particularly when more serious future shocks occur, a more focused approach to the management, monitoring and reporting of the Crown's material assets, liabilities and risks is needed. In particular, more focus is needed on aligning the balance sheet to the Government's overall objectives and integrating reporting on the Crown's balance sheet with overall fiscal reporting and strategy.

This *Investment Statement* is part of this more focused approach.

Objectives for Crown balance sheet management

Recent events in New Zealand and other countries illustrate that there are a number of overall objectives for the effective management of the Crown's assets and liabilities. These are summarised in the box below.

Objectives for Crown balance sheet management

- Provide a buffer against adverse future events, such as economic shocks and risks, and against the fiscal pressures of an ageing population.
- Manage and reduce material risks to the Crown's financial position.
- Maintain a satisfactory credit rating and a low overall cost of capital for the Government and domestic borrowers.
- Assist in addressing domestic economic imbalances (ie, low national savings, high net international investment position).
- Ensure that scarce domestic resources are most effectively employed.
- Ensure that long-term value is created and maintained for taxpayers – by maximising the benefits and performance of current assets.
- Achieve a fair and equitable distribution of benefits, costs and risks between current and future taxpayers.

There are ongoing finance and opportunity costs associated with the Crown's existing assets and obligations – as set out in the box below – that are borne by taxpayers and that reduce the amount of capital available to the Government to invest in higher priorities or pay down debt.

These costs need to be fully recognised in decisions about the best use of Crown capital and the mix of assets the Government should own (in full or in part), in light of alternative ways to achieve the Government's policy objectives.

The cost of holding assets – the Crown’s “cost of capital”

The assets on the Crown’s balance sheet have a cost associated with them which is the cost of capital. If the Crown did not own as many assets, for example, debt would be lower than it would otherwise be, annual interest payments would be lower and the risks associated with ownership would be reduced.

Measuring the Crown’s cost of capital is not straightforward. The Crown faces a direct and obvious cost of borrowing when it raises debt. This cost is almost always lower than that faced by the private sector because sovereign borrowers normally have a higher credit rating than private companies. The Crown’s cost of borrowing (for the benchmark 10-year bond rate) is around 6% in nominal terms (ie, not adjusted for inflation) or around 4% in real or inflation-adjusted terms.

The fact that the Crown has a lower cost of borrowing than the private sector leads some to conclude that the Crown is necessarily best placed to finance investment. But the direct cost of borrowing is not the whole picture. Investments come with risks borne by taxpayers when Crown projects fail to meet expectations. For example, a newly constructed road may fail to support assumed traffic forecasts, or a poorly designed school building might lead to higher than expected maintenance costs over the course of its useful life.

The Crown’s cost of capital therefore reflects *both* the direct cost of borrowing and the risks associated with each of the Crown’s investments.

As a general rule, the best estimate of the Crown’s cost of capital is given by the public sector discount rate of 8% in real terms. This rate reflects the level of Crown debt and the risks associated with the Crown’s activities. If the Crown was to borrow more, or take on activities with greater risk, then its cost of capital would be expected to rise. Conversely, lower debt or reduced risk would be expected to reduce the rate.

There were \$223 billion of assets on the Crown’s balance sheet as at 30 June 2010. The interest expense on the Crown’s debt for the 2009/10 year was \$2.8 billion. But the full annual cost of capital associated with the assets is 8% of \$223 billion, or \$18 billion. To put this in perspective, the size of the Government’s health budget is approximately \$13 billion per annum.

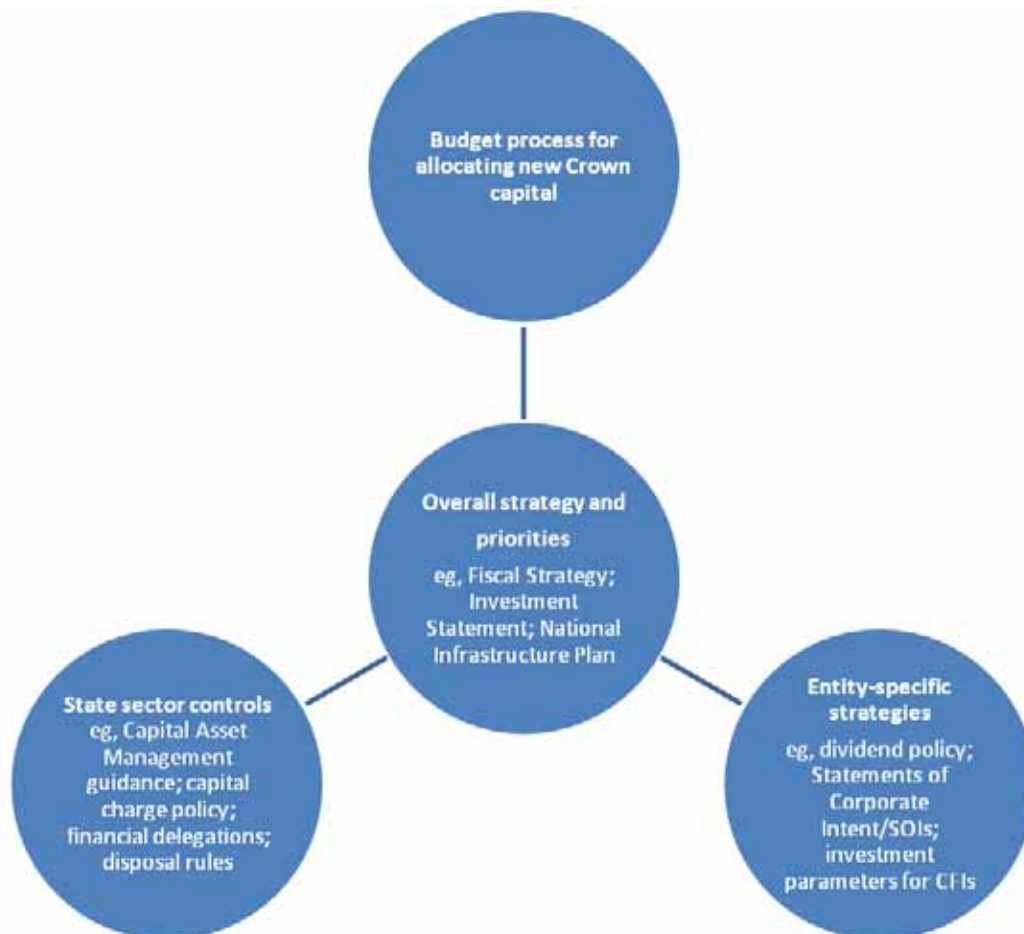
Shaping and managing the Crown’s balance sheet

The Crown’s balance sheet or financial position is influenced by the Government’s **operating balance** (reflecting decisions about levels of government spending and tax), which flows through to debt and net worth, and decisions about **where Crown capital is allocated** and how much to invest. This includes policy decisions about what the Government should own and what liabilities it should take on. It is also impacted by how well managed the Government’s assets and liabilities are, including **the performance/ returns from financial market and commercial exposures**.

Under New Zealand’s public sector management model, most day-to-day decisions about how to manage the Government’s assets, liabilities and risks are made at arm’s length from Ministers. This model is based on the principle that decentralised decision-making is efficient where agencies have better information and are subject to the appropriate incentives.

Key tools for creating the right incentives around the capital allocation process are summarised in the diagram below.

Figure 2 – Tools for creating the right incentives around the capital allocation process



Under this framework, the Government makes a number of choices that directly alter the size, composition and strength of the balance sheet, including setting the size of the new capital allowance each Budget.

The Government also indirectly influences what assets, liabilities and risks are on its balance sheet *and* how well those assets perform through:

- its policy settings (which influence, for example, the value of student loans owed and written down, whether state houses are required to provide housing support and the existence of any deposit guarantees), and
- financial and commercial investment and divestment decisions (for example, the establishment of Kiwibank), and its performance expectations as a shareholder (for example, the dividend policy for SOEs, and the investment parameters for NZSF).

Government also establishes the institutional arrangements that drive decision-making and performance in the public sector and which ultimately influence capital allocation. This includes the governance structures that apply (for example, the establishment of separate Crown Financial Institutions [CFIs]), the incentives and rules influencing the management and disposal of assets and, more generally, the degree of emphasis on contestability in the delivery of public services.

For the Crown’s *commercial portfolio*, with SOEs expected to perform as successful businesses, performance also depends on how well commercial and corporate governance disciplines are replicated in the government sector. Standard corporate governance influences are summarised in the box below, with shading added to indicate those areas that may be weakened under government ownership.

| Corporate governance influences | |
|---|---|
| External | Internal |
| Law/regulation | Board of Directors – role, structure, incentives |
| Markets (1) – Capital markets, market for corporate control, labour/product markets | Managerial incentives – ownership, compensation, employment agreement |
| Markets (2) – Capital market information/analysis | Capital structure – debt/equity |
| Markets (3) – Accounting, financial and legal services | Bylaw & charter provisions |
| Private sources of external oversight – eg, media | Internal control systems |

Source: Gillan, S.: ‘Recent Developments in Corporate Governance: An Overview’, *Journal of Corporate Finance* 12 (2006), 381-402 – shading added

Ensuring that capital is allocated efficiently under the devolved public management system requires looking across all of the Crown’s assets and liabilities to ensure that what the Crown owns and owes is appropriate and well managed. This means ensuring that the Government holds assets and liabilities only where it is best placed to do so, and getting the right tools and settings in place to ensure that these are managed in such a way as to secure the greatest benefits for New Zealanders. Over time, changes in the structure and management of the Crown’s portfolios are expected to be necessary to optimise the size, strength and composition of the Crown’s balance sheet.

It is clear that improvements can be made in a number of areas to support better asset management – and more efficient allocation and use of capital – across the public sector. The disposal of assets is an example (see the box below).

Disposal of surplus assets

An efficient, flexible and responsive disposal process is an important element of any asset and liability management framework. Holding surplus assets reduces the efficiency of the Crown's balance sheet and limits the amount of capital available for other areas. It also leads to unnecessary operating costs for the Crown.

The value of surplus assets held by the Crown may be significant. For example, the Ministry of Education's (MoE) surplus property portfolio as at 30 June 2010 comprises 244 closed schools, teacher houses, vacant sites and other types of assets with a total value of \$95.8 million.

The current process for disposing of surplus assets by a government agency can be complex and time-consuming. Unlike privately-owned property, surplus Crown land or other assets frequently take more than three years to sell owing to requirements such as offer back to previous owners (or their willed successors) under the Public Works Act 1981 and the Māori Protection Mechanism process designed to address the Crown's obligations under the Treaty of Waitangi.

For the 2009/10 financial year, for example, MoE surplus properties took on average 38 months to sell which is at the upper end of the expected range. Contributing factors were delays in the disposal of former Māori land under the offer back process, and delays with Māori Protection Mechanism and Sites of Significance processes owing to the sensitive nature of claim negotiations and awaiting ministerial decisions.

Incentives on agencies to *identify* and dispose of surplus assets may also be weak where they do not face the full cost of capital and when access to capital funding has been relatively easy. Finding ways to improve the use and performance of assets (and supply-side efficiency in general) can, in practice, be a lower priority than other objectives. Capital charge regimes, and increasing transparency and focus on asset utilisation and capital asset management by the Government, are mechanisms for addressing these issues.

Capital allocation in practice: the 2009/10 year in review

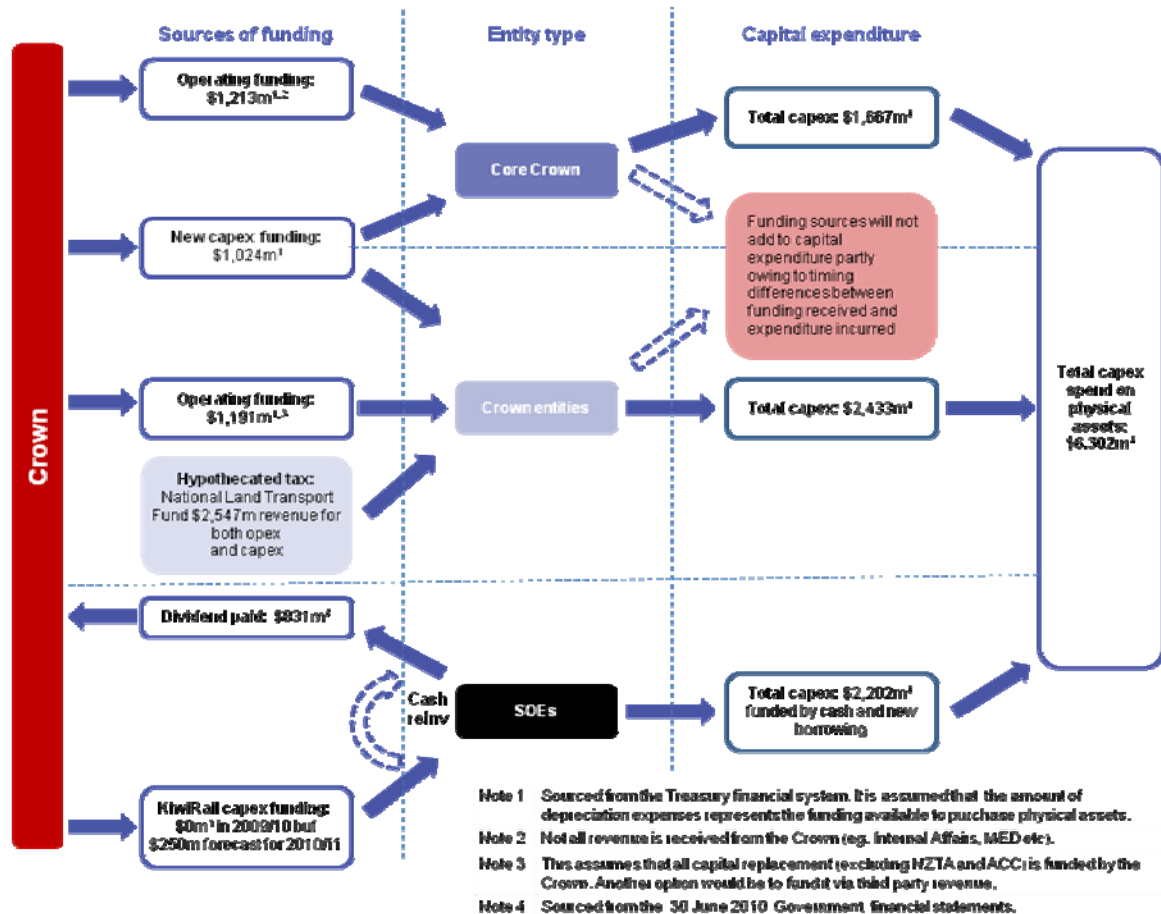
The Government's annual capital budget is in fact a small proportion of the Crown's total investment in any given year. As noted above, the size, shape and strength of the Crown's balance sheet is impacted over time by a number of factors, not all of which are directly controlled by the Government, such as the decisions of autonomous entities that manage the Crown's assets and liabilities. The Treasury's modelling also shows that the largest risk to the Crown's financial position comes from changes in the economy feeding into tax and spending.

Investment in social assets such as schools and defence equipment over the next few years is expected to be largely funded from debt. Some investment is funded by specific taxes (such as the expenditure on roads). Investment in commercial assets is largely financed by cash generated by each of the SOEs, at the expense of dividends received by the Crown which would offset other spending or reduce debt.

As a result of this variety of funding sources and the devolved public management system in which Crown entities and SOEs operate, the amount of Crown capital allocated or invested in any given year far exceeds the amount of the new capital allowance allocated by the Government directly at Budget time.

Figure 3 shows the various capital cash flows for physical and intangible assets in the 2009/10 financial year.

Figure 3 – Cash flows for 2009/10



Source: The Treasury

Figure 3 illustrates that:

- Total Crown capital expenditure on property, plant and equipment in 2009/10 was \$6.3 billion. The \$1.02 billion of the Government's new capital allowance that funded 2009/10 expenditure (a portion of the total \$1.45 billion allocated at Budget 2009) was *less than a sixth of the total spending for the year*.
- SOE capital expenditure on property, plant and equipment (\$2.2 billion) was 35% of Crown-wide capital expenditure.
- The majority of levers available to Ministers within the capital allocation process are over the Core Crown (eg, departments) and Crown entities' cash flows. There are more limited controls in place over capital spending by SOEs (although major investment decisions are subject to consultation and approval processes). This approach is consistent with allowing SOEs to operate in a manner similar to a private sector company.

- A substantial portion of the Crown's capital allocation regime is also funded by agency reserves and depreciation funding¹.

More active overall balance sheet management and strategy should consider whether this allocation of capital across entity types is consistent with long-term government objectives.

Decisions to increase Crown assets given the current fiscal context and outlook need to be well considered and prioritised because, as with all government spending, it is current or future taxpayers who bear the cost. It is essential that all Crown capital is both efficiently allocated and well managed regardless of how it is funded or allocated. For example, a 5% improvement in efficiency across the entire balance sheet would fund the Government's planned new capital allowance for more than a decade (thereby reducing the Crown's borrowing).

¹ "Depreciation funding" is a short hand expression that recognises that when an agency is funded for all of its costs, including the cost of the assets being consumed over time, cash reserves will be available to provide a source of funds for replacement capital expenditure.

Structure of the Investment Statement

This first *Investment Statement* is intended to introduce, explain and discuss the nature and management of the most material assets and liabilities held on the Crown's balance sheet based on Generally Accepted Accounting Practice (GAAP) and current policy settings.

The remaining sections include a review, analysis and discussion of the nature and characteristics of the Crown's balance sheet as follows:

- a descriptive analysis and discussion about how the balance sheet has changed over time, its current composition (with particular focus on the main social assets) and what changes are forecast to occur over the next five years, and
- a summary of the challenges, opportunities and options available to the Crown in ensuring the overall balance sheet and its material assets and liabilities remain fit-for-purpose and aligned with the Crown's overall fiscal strategy and other policy priorities.

Looking forward, it is intended that updates of the type of information contained in this *Investment Statement* will form part of the Government's regular financial reporting.

The Crown's Balance Sheet – An Overview

The accounting basis of Crown balance sheet reporting

Since 1992, the Crown's balance sheet as reported in the Financial Statements of the Government has been based on GAAP using accrual accounting.² New Zealand was one of the first countries in the world to use GAAP for Government financial reporting. Prior to 1992 only accounts showing the cash inflows and outflows from the Crown had been prepared.

The GAAP reporting conventions balance the costs of producing the information against the benefit and aim of capturing all the information required for a relevant and reliable picture of an organisation's finances and risks. This means that the Crown's reported balance sheet does not always recognise assets or liabilities that are intangible, contingent, prospective or implicit, some of which have a potentially significant impact on the Crown's financial position. For example, in respect of risks, recent Treasury modelling has indicated that around 70% of the Crown's financial risk is sourced from changes in the economy feeding into tax and spending, with the remainder attributable to valuation changes in conventional assets and liabilities (Treasury Working Paper 09/06).³ These "off balance sheet" issues are discussed in more detail at the end of Section 3 ("What's not on the balance sheet?") and in Section 4 on balance sheet risks.

GAAP also allows the use of various measurement approaches including depreciated cost, replacement value or some form of market value all of which can give different results for the value of reported assets. Other features of the Crown's reported balance sheet include:

- It is accrual based,⁴ where accrued or deferred revenues and expenses are shown in the balance sheet, as accounts receivable or accounts payable for instance.

² See <http://www.treasury.govt.nz/government/financialstatements/yearend/jun10>

³ Timothy Irwin and Oscar Parkyn (2009) "Improving the Management of the Crown's Exposure to Risk", New Zealand Treasury Working Paper 09/06. See <http://www.treasury.govt.nz/publications/research-policy/wp/2009/09-06>

⁴ Under the accrual concept, transactions and other events are recognised when they occur regardless of the timing of the related cash receipts and payments.

- Potential inflows or outflows that are contingent on a particular future event, which is not considered *probable*, are not reported on the balance sheet but noted as either contingent assets or liabilities. If the potential flows are implicit, rare or difficult to measure then they may be entirely off balance sheet.
- Almost all Crown-controlled entities are consolidated line by line with any related transactions eliminated. A few entities are reported as equity investments.
- Local authorities are not included in the Financial Statements of the Government because they are separate entities not controlled by central government.

How the balance sheet has changed over time

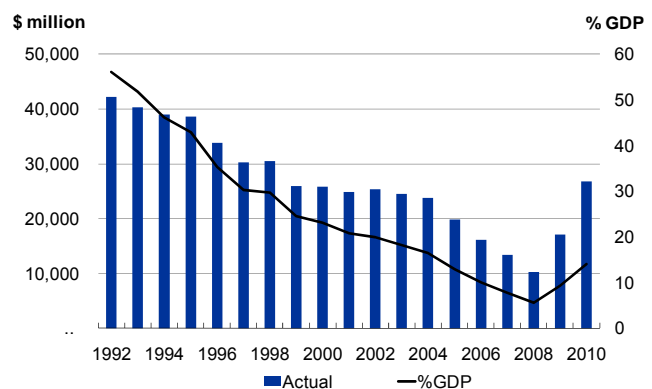
The Crown uses a number of fiscal indicators to measure the overall movements in the balance sheet over time. There are three main balance sheet fiscal indicators: net debt; net worth; and net worth excluding social assets.

All three fiscal indicators show the recent deterioration of the Crown's balance sheet caused by the domestic recession, resulting from structural imbalances in the New Zealand economy, and the global financial crisis. The net debt position of the Crown has worsened as a percentage of GDP for the first time since 1991, indicating a higher debt burden and associated interest costs. Net worth measures have also begun to decline for the first time in a decade.

Net debt

Net debt is the primary fiscal anchor targeted in this Government's fiscal strategy, calculated as core Crown borrowings less financial assets (excluding advances and NZSF financial assets) and is a measure of what the Crown owes in financial terms. It is measured as a percentage of GDP to give an indication of the Crown's ability to service this debt. Figure 4 shows how net debt has trended since 1992.

Figure 4 – Net debt as a percentage of GDP



Source: The Treasury

At 30 June 2010, the New Zealand Crown's level of net debt stood at 14.1 percent of GDP.

Historically, net debt cycles have been long. Net debt trended upwards from 1972 to 1992 (20 years), trended downwards from 1992 to 2008 (16 years) and is forecast at the 2010 Half Year Economic and Fiscal Update (HYEFU) to peak in 2014/15 (7 years) at 28.5% of GDP.

In assessing appropriate and prudent settings for Crown debt levels, it is necessary to take into account the country's net external debt levels as a whole, which are high because of very high private sector external liabilities.

Net worth

Net debt is the measure commonly used in international comparisons, partly because it is commonly available. On its own, however, net debt provides an incomplete measure of the Government's financial position – it excludes, for example, a number of important liabilities and commercial assets.

Net worth is a more complete measure and is an important measure of long-term solvency and the fiscal sustainability of the Crown. It is

calculated as the Crown's total assets less total liabilities, and captures changes to all of the assets and liabilities on the balance sheet. Figure 5 shows how the components of net worth have moved over time in nominal terms along with the resulting net worth value.

The Crown's net worth as a percentage of GDP, shown below, has also increased significantly, illustrating the increasing significance of the Crown's balance sheet in the economy as a whole.

Table 1 – Total Crown net worth as a percentage of GDP (June years)

| 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|------|------|------|------|------|------|------|------|------|------|------|------|------|
| 14.2 | 9.6 | 11.2 | 12.9 | 18.0 | 20.9 | 27.3 | 35.2 | 52.0 | 56.4 | 57.8 | 53.9 | 50.2 |

Source: The Treasury

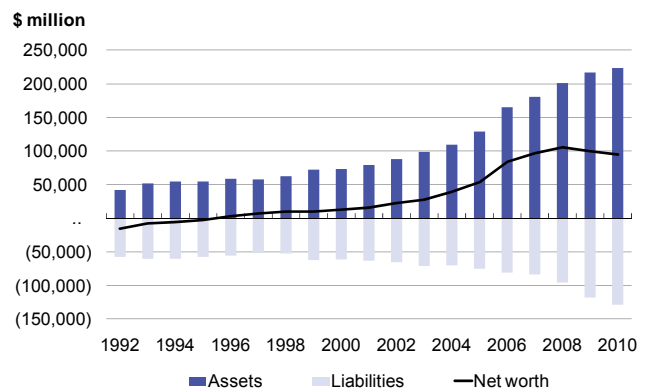
Net worth excluding social assets

Net worth excluding social assets compares financial and commercial assets to liabilities, and is another measure of the Crown's liquidity and solvency.

The measure indicates the Crown's ability to repay its liabilities from its financial and commercial assets alone. These assets are held largely to support the Government's financial management and may therefore provide a more accurate picture of the "buffer" needed alongside low debt levels. (Rising net worth owing to increasing land values under schools and roads is of little value for the Government in creating that buffer.)

Financial and commercial assets generate a financial return to the Crown. For this reason, the risk and volatility of this part of the balance sheet may have greater implications for the Government's fiscal position, and particularly cash flows, than changes in the value of social assets.

Figure 5 – Net worth between 1992 and 2010



Source: The Treasury

The table below shows how net worth excluding social assets has changed since 2002.

Table 2 – Net worth excluding social assets⁵

| \$ million | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 |
|------------|----------|----------|---------|---------|--------|--------|--------|---------|---------|
| | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual |
| NWESA | (21,561) | (20,274) | (1,377) | (6,347) | 3,057 | 9,350 | 10,281 | (1,846) | (7,698) |

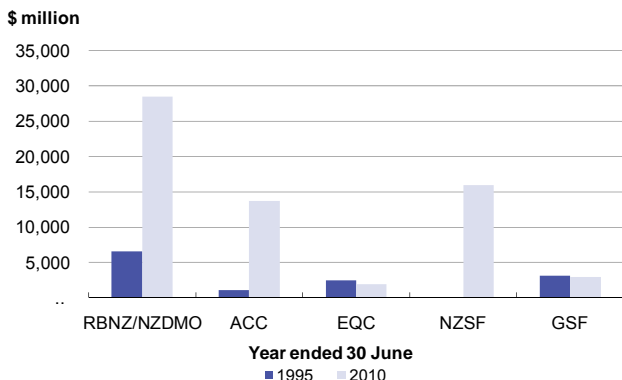
Source: The Treasury

⁵ This is the measure used in Budget documents, which uses a different definition of social assets than is used in this *Investment Statement*. The Budget measure of net worth excluding social assets consists of the financial assets of the core Crown and Crown entities, all the assets of SOEs (excluding the physical assets of KiwiRail) and total liabilities.

How the composition of the balance sheet has changed over time

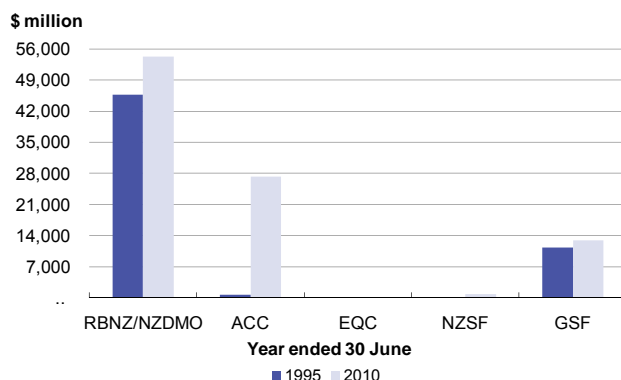
The following charts illustrate the change in the shape of the Crown's balance sheet between 1995 and 2010.

Figure 6 – Financial assets



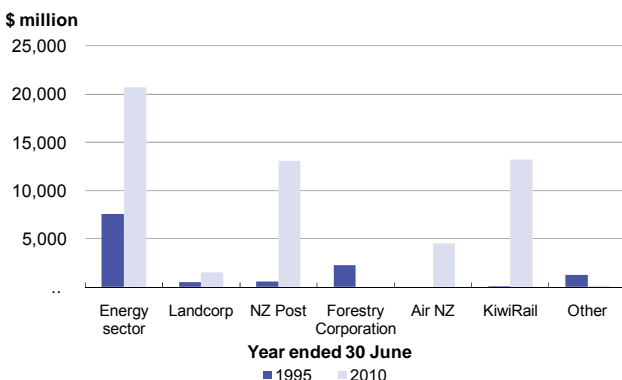
Source: The Treasury

Figure 7 – Financial liabilities



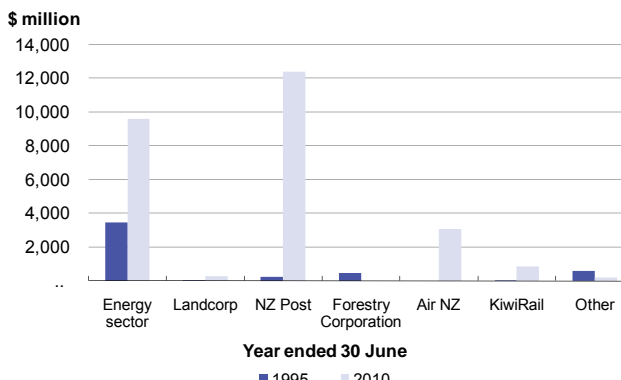
Source: The Treasury

Figure 8 – Commercial assets



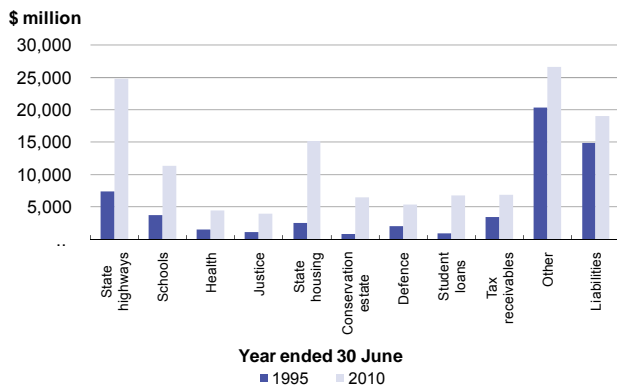
Source: The Treasury

Figure 9 – Commercial liabilities



Source: The Treasury

Figure 10 – Social assets and liabilities



Source: The Treasury

Summary of the Crown's overall balance sheet position

Despite the recent weakening of the New Zealand economy, ongoing structural imbalances and the impacts of the global financial crisis, the Government's balance sheet is in better shape than it was 15 years ago. Assets have grown faster than liabilities over this period, Crown debt has fallen as a proportion of GDP and net worth has increased.

This has been driven by using operating surpluses to retire government debt and invest in public assets, SOEs growing their businesses and a significant increase in financial assets. This includes in particular the establishment of NZSF to partially pre-fund anticipated future expenditure.

Key observations from the charts above include:

- **Size:** The assets and liabilities held on the Crown's balance sheet have increased in size since 1995 after taking into account the impact of inflation. This has been driven from a range of sources including: policy decisions (NZSF and ACC funding); asset creation (Kiwibank, student loans); asset purchase (KiwiRail, shareholding in Air NZ); valuation adjustments (roads, housing, schools, electricity generation assets etc); and accounting changes.
- **Composition:** Assets now exceed liabilities by approximately \$100 billion, whereas in 1995 liabilities exceeded assets by \$3 billion. The Crown now holds a greater portion of its assets as financial and commercial assets. The higher the proportion of these assets that are marked to market, the more volatility there will be in reported asset balances. Notwithstanding the increased proportion of financial and commercial assets, social assets have almost doubled over that period, with significant increases in the stock of roads, houses, schools and student loans.
- **Strength:** The movement to more liquid assets (financial assets and to some extent commercial assets) and the growth in the assets compared to liabilities means that the Crown balance sheet is in a much better position to withstand shocks than it was in 1995. This was, and is, being tested by the impacts of the domestic recession and the global financial crisis which have negatively impacted the balance sheet, and the Crown's financial position is expected to continue to worsen further before it gets better.

The Government's specified target is to maintain net debt closer to 20% of GDP over the long term. Net core Crown debt is forecast in HYEUFU 2010 to increase to 28.5% by 30 June 2015 and is not now forecast to fall below 20% until 2022. As already noted, off balance sheet risks, such as further weakening of the economy reducing the Crown's forecast revenues, pose the greatest threat to this position over the medium term.

Another indicator of the strength of the Government's overall financial position is its credit rating with the balance sheet forming a part of the credit rating assessment by international credit rating agencies. These agencies also put weight on the importance of transparency in the Government's finances in determining sovereign credit ratings. Deterioration in the Crown's credit rating would lead to higher borrowing costs. Higher borrowing costs would take up a greater portion of the Crown's tax take at the expense of other services provided, and invariably flow through to higher borrowing costs for New Zealand-domiciled firms.

New Zealand's credit rating is analysed and published by Moody's Investors Service, Standard and Poor's (S&P) and Fitch Ratings.⁶ The rating agencies issue short- and long-term ratings for both domestic and foreign-currency debt. The long-term foreign-currency rating is the rating most commonly used for international comparisons.

New Zealand's long-term foreign-currency rating has fluctuated between AAA/Aaa (Triple A) and AA-/Aa3 over the past three decades. AAA is the highest rating level while a rating in the AA/Aa range is also seen as a very high level of credit-worthiness.

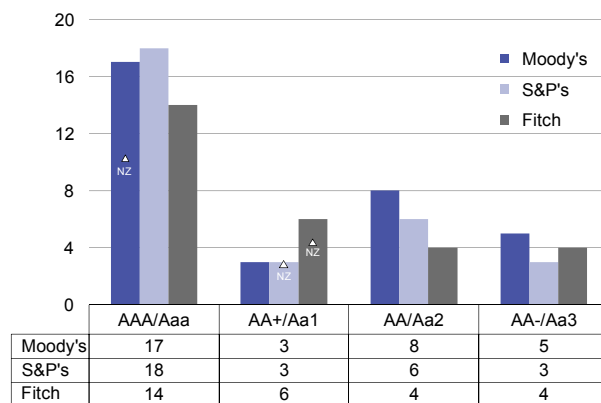
New Zealand's long-term foreign currency credit rating is currently Aaa with a stable outlook from Moody's and AA+ (negative outlook) with S&P and Fitch. Most recently, S&P revised their outlook for New Zealand's credit rating from stable to negative on 22 November, commenting on the need for evidence of the unwinding of the structural imbalances in the economy. The domestic currency rating is Triple A with all three agencies.

International comparisons

Figure 11 shows sovereign credit ratings for New Zealand and other countries. Those countries with a Triple A credit rating from all three agencies include Canada, France, Germany, Norway, Sweden, Switzerland, UK and USA.

S&P and Fitch highlight New Zealand's high level of external indebtedness as the main reason for the lower rating. In this context, it is important for the Government to maintain a strong balance sheet and a relatively low level of sovereign debt. Other countries with weak private or household savings and high national levels of external liabilities have lower credit ratings. New Zealand remains amongst the top 20 rated sovereigns in the world.

Figure 11 – Number of Sovereigns in Prime and High Quality Grades



Sources: Moody's Investors Service, S&P, Fitch Ratings

Except in the case of sovereign debt, for which analysis is more readily available, other international comparisons are difficult owing to the relatively poor balance sheet reporting by other countries. Nevertheless, some broad comparisons are possible. These are summarised in the box below.

⁶ See <http://www.nzdm.govt.nz/sovereigncreditratings>

How does the Crown's balance sheet compare with other countries?

International comparisons of governments' balance sheets are extremely difficult owing to data limitations and different measurement bases: very few governments report GAAP balance sheets; international data sources are limited by the quality of countries' own information; and different levels of government can complicate the analysis. Even so, some broad high-level comparisons are possible.

Overall, the balance sheet is comparatively strong. The overall measure, net worth, is very difficult to compare. The most comparable international measure is gross debt, which is a substantial driver of overall net worth. New Zealand has comparatively lower sovereign debt as a share of GDP than many other countries. A relatively strong government balance sheet is warranted in light of New Zealand's high levels of private net foreign liabilities.

Financial assets are comparatively modest. The CFIs are relatively modest in size compared internationally. Countries such as Norway, China and Singapore have extremely large Sovereign Wealth Funds. New Zealand's Superannuation Fund is slightly larger than Australia's Future Fund as a share of GDP.

Liabilities other than debt are relatively low. The most significant liability (other than debt) for many governments that would be recognised on the GAAP balance sheet is public sector defined benefit pension schemes (that is, schemes that provide a fixed portion of final salary, for example).⁷ Most governments' pension liabilities are not fully reported, but the UK and many US states, for example, still operate such schemes and face substantial future liabilities. In comparison, New Zealand's defined benefit scheme (ie, the Government Superannuation Fund, GSF) has been closed to new members since 1992 and the unfunded liability is substantially smaller.

The commercial portfolio is comparatively large and tends to be 100% owned. The OECD's public ownership indicator puts New Zealand in roughly the middle of OECD countries. However, two features of New Zealand's public ownership not fully captured by that indicator are that it is large as a proportion of GDP (reflecting the large size of the electricity SOEs in particular), and the companies are predominantly in 100% public ownership rather than a mix of public and private. Since the most recent data, some countries have increased ownership in the financial sector in light of the global financial crisis owing to bail-outs which New Zealand has avoided.

Other assets reflect policy choices about how best to deliver and finance public services. The fact that the largest government assets include roads, schools and prisons is similar to many countries. Policy choices are the main influence on what assets are on balance sheets. For example, the dominance of social housing on the Crown's balance sheet reflects the choice of government to centrally provide social housing to those with high housing needs, whereas some other countries devolve housing provision to local authorities, or have larger not-for-profit sectors.

⁷ Note that NZ Superannuation and its equivalent in other countries is treated as current expenditure and is not reported as a future liability on a GAAP balance sheet. The sustainability of NZ Superannuation is covered in *Challenges and Choices: New Zealand's Long Term Fiscal Statement*. See: <http://www.treasury.govt.nz/government/longterm/fiscalposition/2009>

3

Major Assets and Liabilities on the Crown's Balance Sheet

Current structure and organisation of the Crown's assets and liabilities

In this *Investment Statement* each of the assets and liabilities of the Crown have been classified into the following categories:

| | |
|-----------------------------------|--|
| Social assets and liabilities | Assets and liabilities held by the Crown primarily to provide public services or to protect assets for future generations. These include, for instance, roads, schools and the national parks. For the purposes of this document, social assets also include tax receivables and student loans managed by Inland Revenue, and Crown companies that do not have purely commercial objectives (such as the Crown Research Institutes [CRIs] and TVNZ). |
| Financial assets and liabilities | Assets and liabilities held by the Crown to finance or pre-fund government expenditure and to recognise the obligation for future expenditure. This category is comprised of the CFIs (NZSF, ACC, EQC and GSF), the central bank (RBNZ) and government borrowing (NZDMO). |
| Commercial assets and liabilities | A portfolio of companies held by the Crown with purely commercial objectives. The companies are largely self-sustaining entities operating in openly competitive environments. This category is comprised of all the SOEs and Air New Zealand. |

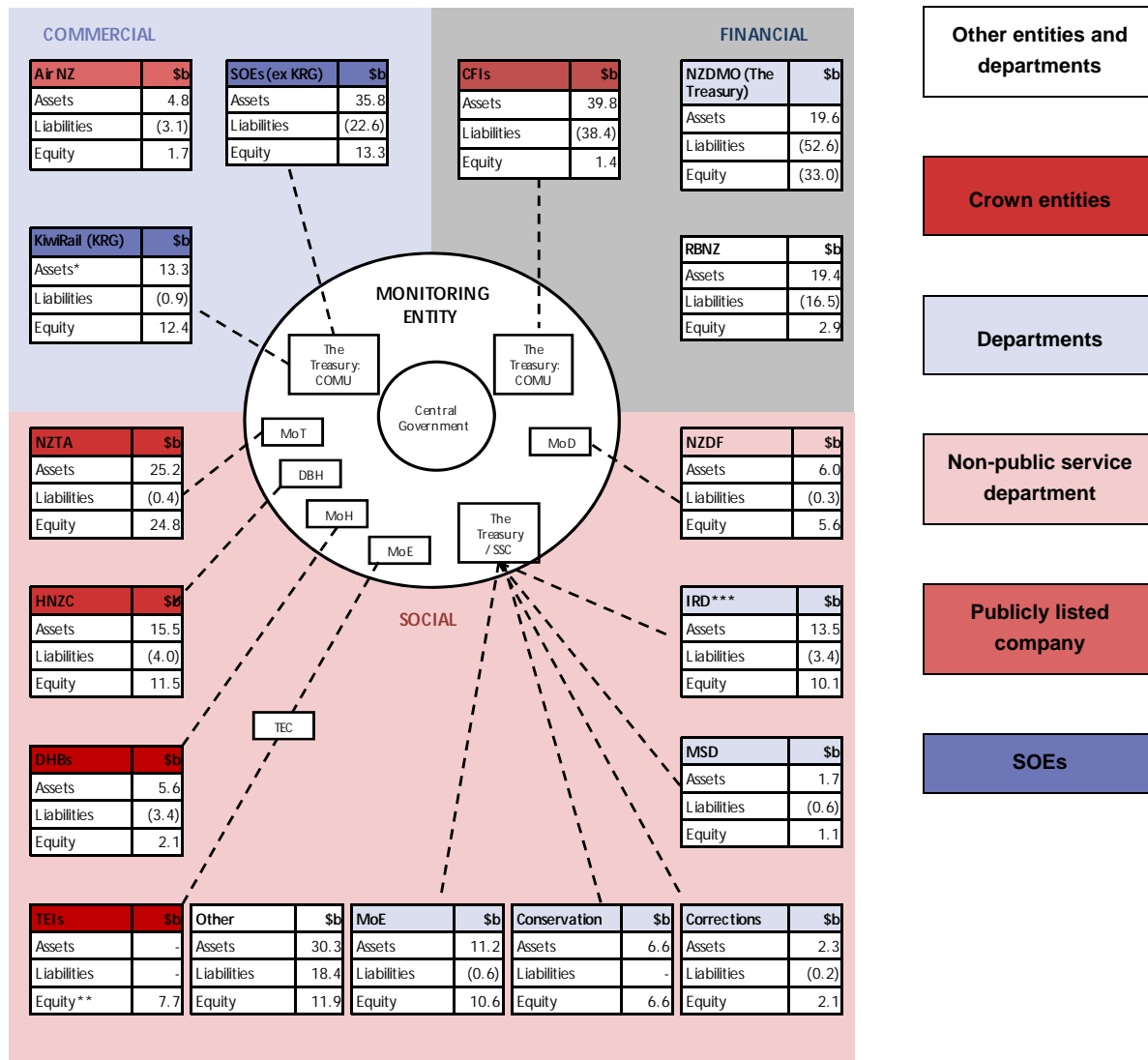
The following diagram provides a snapshot of the structure of the Crown's material assets and liabilities, split into social, commercial and financial categories. The diagram also shows the relationships between the entities managing assets and liabilities and the departments monitoring those entities on behalf of central government.⁸

⁸ The values shown in the diagram are gross. This means that they represent the assets and liabilities of the specified reporting entities, without removing the effect of any transactions with other government entities. Consequently, if all the asset figures in the diagram are totalled, they will exceed the total government assets which are consolidated and which *do* remove inter-entity transactions.

In addition, the liabilities of the social entities understate the level of debt funding used to support these entities. This is because the issuance of government debt is managed centrally by NZDMO, which is shown as having a large negative equity balance in the diagram. This negative equity is more than balanced by the extent of the assets in the social entities.

A copy of the actual balance sheet (Statement of Financial Position) as presented in the *Financial Statements of the Government of New Zealand June 2010* follows the diagram for reference. The supporting notes in this document are an integral part of the Crown balance sheet and can be accessed at the Treasury website.⁹

Figure 12 – Balance sheet values as at 30 June 2010



* The accounting valuation of \$13.3 billion assumes the company is a 'public benefit entity' rather than a commercially viable enterprise.
 ** TEIs are only equity accounted in the Crown's accounts, which is why no values for assets and liabilities are shown.
 *** These are IRD Crown values only.

Source: The Treasury

Refer to the Glossary of Terms on page 94 for an explanation of acronyms.

⁹ See <http://www.treasury.govt.nz/government/financialstatements/yearend/jun10>

Statement of Financial Position

as at 30 June 2010

| Forecast | | | Actual | |
|--------------------|-------------------|--|----------------|----------------|
| Original Budget | Estimated Actuals | | 30 June 2010 | 30 June 2009 |
| \$m | \$m | | \$m | \$m |
| Assets | | | | |
| 5,042 | 6,143 | Cash and cash equivalents | 7,774 | 6,268 |
| 14,093 | 13,813 | Receivables | 13,884 | 14,619 |
| 49,683 | 45,465 | Marketable securities, deposits and derivatives in gain | 43,687 | 45,708 |
| 11,867 | 15,675 | Share investments | 12,179 | 11,160 |
| 17,268 | 17,967 | Advances | 18,447 | 15,604 |
| 1,165 | 1,177 | Inventory | 1,160 | 1,082 |
| 1,836 | 1,518 | Other assets | 1,661 | 1,630 |
| 110,251 | 113,634 | Property, plant & equipment | 113,330 | 110,135 |
| 9,197 | 8,925 | Equity accounted investments | 9,049 | 8,777 |
| 2,133 | 2,320 | Intangible assets and goodwill | 2,184 | 2,168 |
| 72 | - | Forecast for new capital spending | - | - |
| (375) | (125) | Top-down capital adjustment | - | - |
| 222,232 | 226,512 | Total assets | 223,355 | 217,151 |
| Liabilities | | | | |
| 4,220 | 4,147 | Issued currency | 4,020 | 4,005 |
| 10,296 | 8,950 | Payables | 9,931 | 9,139 |
| 1,213 | 1,331 | Deferred revenue | 1,628 | 1,426 |
| 76,423 | 73,643 | Borrowings | 69,733 | 61,953 |
| 25,345 | 27,305 | Insurance liabilities | 27,131 | 26,567 |
| 10,307 | 9,158 | Retirement plan liabilities | 9,940 | 8,993 |
| 4,479 | 5,499 | Provisions | 5,984 | 5,553 |
| 132,283 | 130,033 | Total liabilities | 128,367 | 117,636 |
| 89,949 | 96,479 | Total assets less total liabilities | 94,988 | 99,515 |
| Net Worth | | | | |
| 31,803 | 34,027 | Taxpayer funds | 31,087 | 36,382 |
| 57,723 | 62,110 | Property, plant and equipment revaluation reserve | 63,593 | 62,612 |
| 41 | (105) | Other reserves | (94) | 74 |
| 89,567 | 96,032 | Total net worth attributable to the Crown | 94,586 | 99,068 |
| 382 | 447 | Net worth attributable to minority interest in Air New Zealand | 402 | 447 |
| 89,949 | 96,479 | Total net worth | 94,988 | 99,515 |

Social assets and liabilities

Introduction

Purpose

Social assets fulfil a range of functions including supporting the provision of services to the public, where Crown ownership has been seen as a necessary or preferable means of delivery.

Most liabilities incurred to support the provision of social assets are managed centrally by NZDMO, which is discussed separately in the Financial assets and liabilities section.

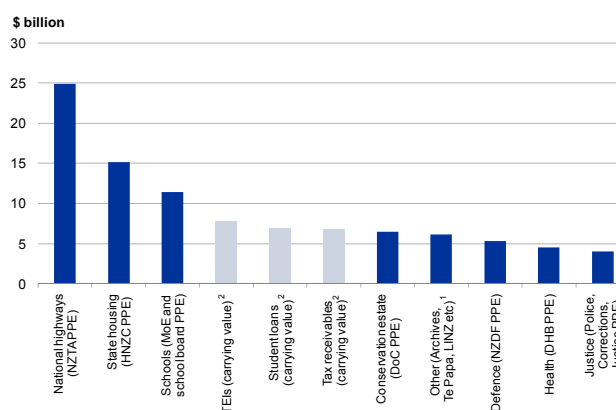
Current holdings

The value of all Crown assets held by the agencies included in the category of “social assets and liabilities” in this *Investment Statement* totals \$111 billion at 30 June 2010.

This section of the *Investment Statement* focuses on major elements to the value of \$93 billion, comprising property, plant and equipment (PPE), such as schools, hospitals, prisons and roads, as well as the carrying value of tax receivables, student loans and the Crown’s equity in Tertiary Education Institutions (TEIs).

The remaining \$18 billion is made up of intangibles, inventory, cash and other minor asset classes, as well as all the assets of financially smaller entities. The following chart shows the current breakdown of the value of the major social assets discussed in this section.¹⁰

Figure 13 – Major social assets at 30 June 2010



Source: The Treasury

Notes:

- 1 The “other” section captures the PPE of all other social entities. Notably, this includes TVNZ and the CRIs such as AgResearch, Institute of Environmental Science and Research and SCION. Additional values captured within “other” include the PPE of policy and monitoring agencies not represented elsewhere, and financially smaller entities such as Te Papa, Archives New Zealand and Land Information New Zealand.
- 2 The three light blue elements (tax receivables, student loans and TEIs) in the chart are not PPE values. TEIs are treated as an equity accounted investment (rather than PPE) owing to a lack of clarity regarding the relevant accounting standard. Note 21 of the *Financial Statements of the Government of New Zealand* (30 June 2010) discusses this issue in detail.

¹⁰ The values provided refer directly to the PPE of entities that carry the major types of social assets on their balance sheets. In practice there will be assets other than the major social assets within the PPE of an entity, but these are typically minor in comparison (for example, the value of computers at MoE is a minor element when compared to the value of schools, but both are captured within the Ministry’s PPE value in the chart).

The table below reconciles changes to the total value of major social assets over time, and outlines how they are anticipated to change out to 2014/15. It shows the impact of additions (cash spent on assets), disposals (selling of assets), revaluations of assets and depreciation (which reduces asset carrying values over time). Capital injections that have been approved by the Government through decisions already taken are included in the forecasts. The forecast years do not include new Crown capital injections that may be sought in future Budgets or any estimate for asset revaluations.

Only the assets representing PPE values are included, meaning that tax receivables, student loans and TEIs are excluded.

The table shows that additions of \$17.6 billion are planned between 2010 and 2015, while the carrying value of the assets will only rise by \$5.7 billion. This indicates the scale of cash expenditure on assets can be far larger than the change in asset carrying values over time. The impact of depreciation masks the scale of government investment in these assets.

Actual and forecast changes to the value of social assets

| (\$ million) | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Total across forecast period |
|-----------------|---------|---------|---------|---------|----------|----------|----------|----------|----------|------------------------------|
| | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast | |
| Opening balance | 56,531 | 60,733 | 65,919 | 70,868 | 71,263 | 73,185 | 74,755 | 75,718 | 76,296 | |
| Additions | 2,776 | 2,688 | 3,758 | 3,647 | 4,268 | 3,793 | 3,322 | 3,007 | 3,184 | 17,574 |
| Disposals | (171) | (345) | (435) | (250) | (120) | (85) | (118) | (150) | (222) | (695) |
| Revaluations | 3,046 | 3,460 | 3,383 | (458) | - | - | - | - | - | - |
| Depreciation | (1,702) | (1,742) | (1,921) | (2,042) | (2,100) | (2,197) | (2,258) | (2,269) | (2,263) | (11,087) |
| Other movements | 253 | 1,125 | 165 | (503) | (126) | 59 | 17 | (10) | (10) | (70) |
| Closing balance | 60,733 | 65,919 | 70,869 | 71,263 | 73,185 | 74,755 | 75,718 | 76,296 | 76,984 | |

Source: The Treasury

Summary performance measures

This *Investment Statement* focuses on the performance and management of the Crown's assets and liabilities. Therefore, the following sections on each of the major social assets attempt to summarise available information which relates specifically to asset utilisation and performance rather than more generally to efficiency and effectiveness in the delivery of services. For each of the major social assets, other government reports are available providing a richer set of performance objectives and measures for the delivery of services.

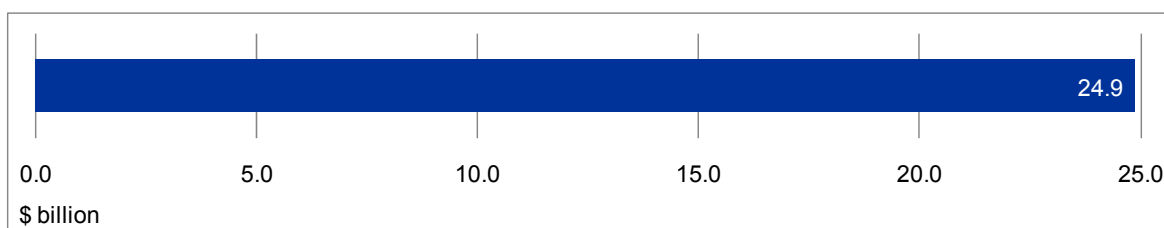
The information available on asset performance is relatively weak in general and poorer in some areas more than others. This makes it difficult to draw firm conclusions on the "return" from Government's investment in social assets and how well these assets are being managed. Nonetheless, based on the information presented here and information collected as part of the Government's Capital Asset Management programme (including an examination of the 10-year capital intentions provided by capital-intensive agencies), the following common themes emerge:

- Generally, asset disposals are low. The tendency has been to accumulate more assets, rather than releasing capital for better use, even within the same sector. This has been possible in part owing to the relatively easy availability of new capital as well as lack of transparency.
- Longer term capital planning is essential but still emerging (the Capital Asset Management programme and *National Infrastructure Plan* are steps towards this).

- Whole-of-life management of assets is needed to support making appropriate trade-offs between capital and operating expenditure – both of which are simply uses of public resources. Commercial disciplines, such as Public-Private Partnerships (PPPs), are one way of achieving this.
- There is limited contestability of supply for many of the major social assets, and so limited competitive pressure or external benchmarking applied.
- Good indicators of efficient capital use are almost universally absent.

Taken together, these problems make for poor use of resources.

State highways



PPE managed by the New Zealand Transport Agency (NZTA) as at 30 June 2010

10,984 km of state highways

21.1 billion km of travel per annum including **210 million tonnes** of freight

- Critical transport infrastructure
- Assets incur significant renewal, maintenance and operating costs
- Roads of national significance identified and related projects to be advanced

Description

State highways are a key element of national transport infrastructure. NZTA is responsible for managing the state highways and is also a significant funder of local roads. The National Land Transport Fund (NLTF) is the main source of NZTA funding. The NLTF is primarily funded by road users through fuel excise duty, charges on diesel and heavy vehicles (road user charges) and motor vehicle registration and licensing fees. The NLTF also funds Crown contributions to local roads and other transport infrastructure which do not feature on the Crown's balance sheet.

Performance

The following table outlines NZTA measures of state highway asset condition:

| | 2006/07 | 2007/08 | 2008/09 | 2009/10 |
|------------------------------------|---------|---------|---------|---------|
| Classified as smooth | 99.0% | 99.0% | 99.0% | 98.8% |
| Good skid exposure above threshold | 99.0% | 98.0% | 97.6% | 98.4% |
| | 2009 q3 | 2009 q4 | 2010 q1 | 2010 q2 |
| Availability of state highway | 99.7% | 99.6% | 99.6% | 99.5% |
| | 2003 | 2006 | 2009 | |
| Road user satisfaction | 78% | 73% | 89% | |

Actual and forecast movements of NZTA PPE

| (\$ million) | 2007 Actual | 2008 Actual | 2009 Actual | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | Total across forecast period |
|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|---------------------------------|
| Opening balance | 17,930 | 19,400 | 20,947 | 24,085 | 24,861 | 25,662 | 26,452 | 27,186 | 27,946 | |
| Additions | 912 | 1,012 | 1,207 | 1,267 | 1,341 | 1,216 | 1,159 | 1,189 | 1,378 | 6,283 |
| Disposals | (27) | (26) | - | (17) | (15) | (20) | (15) | (14) | (14) | (78) |
| Revaluations | 884 | 863 | 2,290 | (64) | - | - | - | - | - | - |
| Depreciation | (299) | (302) | (377) | (407) | (393) | (395) | (400) | (405) | (405) | (1,998) |
| Other movements | - | - | 18 | (3) | (132) | (10) | (10) | (10) | (9) | (171) |
| Closing balance | 19,400 | 20,947 | 24,085 | 24,861 | 25,662 | 26,452 | 27,186 | 27,946 | 28,896 | |

Source: The Treasury

Risks and challenges

The state highway network and its assets are currently deemed to be in adequate condition overall. Ongoing costs of renewal, maintenance and operation of state highways are significant with planned expenditure between 2009 and 2012 of \$1.5 billion on these functions.

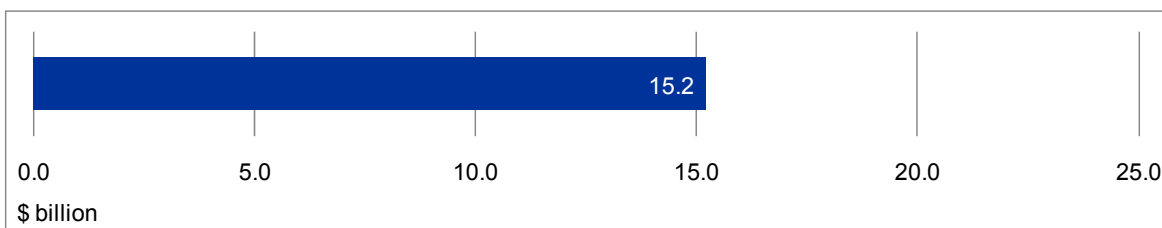
Government priorities

A state highway classification system to guide future investment and management of the network is being developed and will involve categorising state highways based on the volume of traffic they carry and the function they perform – whether that's the movement of freight, everyday travel or tourism.

The Government has identified seven essential state highways that are linked to New Zealand's economic prosperity. Called the roads of national significance, NZTA is charged with delivering these highway projects within the next 10 years which will improve the transport connections in and around the five largest urban centres.

Other possible funding and financing sources for the NLTF that could be considered to support investment include tolls, PPPs (where a business case can demonstrate sufficient benefits) and other third party contributions (such as developer contributions or borrowing).

State housing



PPE managed by HNZN as at 30 June 2010

69,000 houses providing housing for **200,000** people
 Forecast market rent of **\$955 million**
10,000 applicants on the waiting list

- Provides housing for people with high housing needs
- Challenges in matching supply to demand and prioritising highest need
- Consideration of alternative ways to meet demand

Description

State housing provides accommodation for people who have difficulty accessing housing in the private rental market. HNZN manages state housing on behalf of the Crown. Approximately 5% of the portfolio is leased and is not on the Crown's balance sheet (and is not, therefore, included in the asset value shown above).

HNZN receives a market rent for its houses – this is made up of rental income from tenants and an Income Related Rent (IRR) subsidy from the Government for eligible tenants. HNZN forecasts direct rental income of \$396 million and an IRR subsidy of \$559 million in 2010/11, providing \$955 million total income.

Performance

The value of the Crown's housing asset has grown over the past 10 years owing primarily to property price increases, providing a strong total return to the Crown. Similarly, future returns will be affected by the extent of property price movements.

HNZN uses a narrower "return on equity" (ROE) measure to track its performance. While this measure excludes property revaluations from profit figures, it is affected by revaluations that increase the amount of equity upon which that profit is generated. This makes achieving improved ROE difficult in times of rapidly rising property prices. HNZN's ROE (pre-tax) averaged less than 1% in the last seven years, and has been decreasing since 2002/03. ROE is targeted to increase from a forecast of 1.17% in 2010/11 to 1.37% in 2012/13.

The vacancy rate on properties for the 2009/10 year was 0.8%. The current land to improvement value ratio of 1.7:1 is well below HNZN's recently developed target of 1:2.

Forecast and actual HNZN PPE

| (\$ million) | 2007 Actual | 2008 Actual | 2009 Actual | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | Total across forecast period |
|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|---------------------------------|
| Opening balance | 13,220 | 14,870 | 15,176 | 14,634 | 15,213 | 15,184 | 15,193 | 15,215 | 15,233 | |
| Additions | 168 | 259 | 315 | 306 | 259 | 247 | 328 | 320 | 302 | 1,456 |
| Disposals | (25) | (25) | (46) | (68) | (39) | (51) | (110) | (112) | (114) | (426) |
| Revaluations | 1,686 | 269 | (645) | 485 | - | - | - | - | - | - |
| Depreciation | (165) | (175) | (173) | (166) | (173) | (176) | (183) | (184) | (186) | (902) |
| Other movements | (14) | (22) | 7 | 22 | (76) | (11) | (14) | (6) | (6) | (113) |
| Closing balance | 14,870 | 15,176 | 14,634 | 15,213 | 15,184 | 15,193 | 15,215 | 15,233 | 15,228 | |

Source: The Treasury

Risks and challenges

The state housing portfolio houses many vulnerable New Zealanders. However, tenants' needs change over time and current state house tenants are not always those with the highest need. There is a mismatch between the size and location of state houses and the housing requirements of people with the highest housing needs.

Better targeting existing state housing would require actively managing low-needs tenants into non-state housing. Currently there are between 4,000 and 5,000 applicants with high need on the waiting list, while around 11,500 houses are rented without, or with a very low, IRR subsidy suggesting comparatively low need.

HNZN's low return on equity partially reflects that it incurs costs that the private sector can avoid, including:

- facilitating improvement in communities where state housing dominates
- providing advice about the range of options available to those who approach HNZN for assistance and to existing tenants
- supporting higher needs occupants of social housing including Community Group Housing, and
- specialised tenant support.

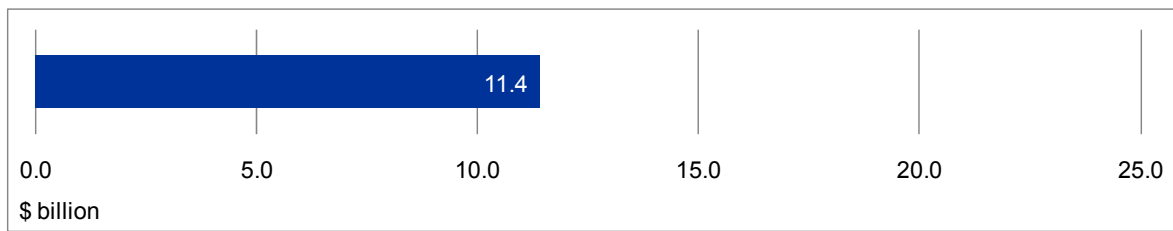
To meet immediate challenges, the actions set out in the *HNZN Asset Management Strategy* will increase the number of properties that are "fit for purpose" by virtue of location, quality and type by 9,000 over the coming 10-year period. This will be done by a combination of redevelopment, upgrades, sales and acquisition.

Government priorities

The Government provides housing to ensure that the most vulnerable people are housed. Given the pressures on state housing there is a growing need to consider alternative approaches to ensuring that people have adequate housing. The Housing Shareholders' Advisory Group has recently provided the Government with a number of recommendations for meeting challenges in social housing, including, for example, increasing provision by third parties.¹¹

¹¹ See <http://www.dbh.govt.nz/vision-for-social-housing-nz-press-release>

Schools



PPE managed by MoE and school boards of trustees as at 30 June 2010

2,335 schools¹²

16% of surplus stock

Annual capital spend over **\$700** million

- Contributes to compulsory education
- Weathertightness issues and demographic trends drive costs
- PPPs being considered for new schools

Description

New Zealand's public education system provides compulsory schooling for over 600,000 students. MoE is responsible for the Crown's ownership interest in school property, while school boards of trustees manage day-to-day decisions.

The Ministry sets the policy environment for school property, ensures that there is sufficient capacity to meet demand and is responsible for disposing of surplus property. The Ministry's role includes funding and monitoring of boards for maintenance and refurbishment of schools. MoE's property portfolio includes 18,000 hectares of land and 17,000 buildings.

Performance

The Ministry has goals of maintaining the real cost per student for the construction of new schools at 2009 levels, and reducing surplus property stock from 16% to 10% by 2015. At 30 June 2010 there were 40 school properties that were closed and were in the disposal process.

The Ministry also has the following performance indicators:

- Capital plan programmes achieve 90% of the deliverables on time, to budget.
- Ninety-nine percent of schools have an approved Ten-Year Property Plan.
- Weathertightness problems are resolved for schools within 18 months of initial notification for 80% of cases.

¹² In addition to the 2,335 state schools, a further 328 state integrated schools receive some operational and property funding. The Crown does not own these schools and they are not included on the Crown's balance sheet or in this *Investment Statement*.

Actual and forecast MoE and school boards of trustees PPE

| (\$ million) | 2007 Actual | 2008 Actual | 2009 Actual | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | Total across forecast period |
|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|---------------------------------|
| Opening balance | 11,093 | 10,871 | 11,817 | 12,206 | 11,387 | 11,741 | 11,829 | 11,881 | 11,903 | |
| Additions | 509 | 550 | 671 | 776 | 979 | 727 | 679 | 672 | 673 | 3,730 |
| Disposals | - | (83) | (63) | (68) | (20) | (20) | - | (20) | (25) | (85) |
| Revaluations | (303) | 851 | 287 | (424) | - | - | - | - | - | - |
| Depreciation | (529) | (495) | (556) | (579) | (606) | (620) | (626) | (631) | (637) | (3,120) |
| Other movements | 101 | 123 | 50 | (524) | - | - | - | - | - | - |
| Closing balance | 10,871 | 11,817 | 12,206 | 11,387 | 11,741 | 11,829 | 11,881 | 11,903 | 11,914 | |

Source: The Treasury

Risks and challenges

A large number of New Zealand schools are suffering from weathertightness issues, and the total nation-wide cost of repairing the damage is estimated to be \$0.9 billion.

Population growth, internal migration and inflexible policy settings create ongoing property demand pressures. New Zealand has experienced a sharp increase in the birth rate in recent years with a significant impact on primary schools predicted from 2012. Retention rates in secondary schools have also increased. It is estimated that 2,500 additional teaching spaces will be needed by 2020. The ongoing trend of northward migration also means that student numbers have declined in some areas leaving schools with more property than required.

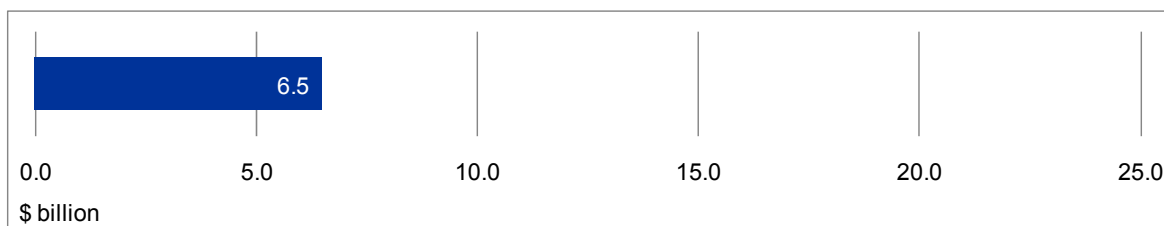
Some school boards have limited skills and expertise to effectively undertake their property management functions which creates risk. Almost 70% of school buildings are between 30 and 100 years old.

Government priorities

New standards for school buildings are being developed and a new condition assessment methodology for schools to use to assess their property. This will assist with the provision of forecasting the future costs of maintaining and modernising schools.

The Government wants to improve procurement efficiency and is investigating the costs and benefits of using PPPs for the construction and management of school buildings.

Conservation estate



PPE managed by the Department of Conservation (DOC) as at 30 June 2010

8 million hectares of land including **14** national parks used by **4,500** businesses under licence

- Conservation of natural and human heritage
- Trade-off between protection and development
- Commercial opportunities to be investigated

Description

Public conservation land is owned and managed by the Government to preserve the common heritage of all current and future New Zealanders, while fostering recreation and tourism. This land includes national parks, high country parks, forest parks, offshore and subantarctic islands and historic sites.

Public conservation land has a carrying value of \$5.9 billion, although this does not incorporate the value of ecosystems and ecosystem services. The land is managed by DOC under a range of legislation and classifications (eg, national parks, conservation parks, stewardship areas, scenic and other reserves and wildlife refuges).

Performance

Tracking changes in native vegetation cover as a whole, by environment type/level of protection and trends in the benefits New Zealanders seek and receive from areas managed by DOC are the key effectiveness measures.

Actual and forecast DOC PPE

| (\$ million) | 2007 Actual | 2008 Actual | 2009 Actual | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | Total across forecast period |
|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|---------------------------------|
| Opening balance | 4,402 | 5,174 | 6,016 | 6,644 | 6,467 | 6,498 | 6,554 | 6,587 | 6,611 | |
| Additions | 64 | 110 | 196 | 71 | 60 | 63 | 48 | 47 | 49 | 267 |
| Disposals | - | (23) | (92) | (13) | (8) | (2) | (2) | (2) | (2) | (16) |
| Revaluations | 705 | 783 | 538 | (186) | - | - | - | - | - | - |
| Depreciation | (23) | (25) | (24) | (27) | (29) | (28) | (28) | (27) | (27) | (139) |
| Other movements | 26 | (3) | 10 | (22) | 8 | 23 | 15 | 6 | 5 | 57 |
| Closing balance | 5,174 | 6,016 | 6,644 | 6,467 | 6,498 | 6,554 | 6,587 | 6,611 | 6,637 | |

Source: The Treasury

Risks and challenges

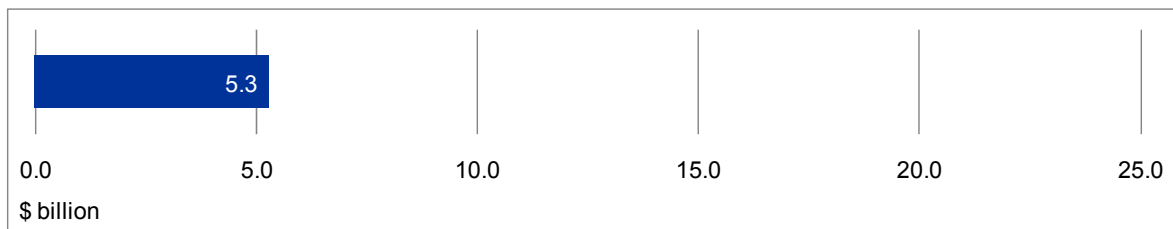
Management of the conservation estate requires considering the:

- balance between protection and development outcomes for New Zealand
- extent of community and Tangata Whenua input into management decisions and conservation activities, and
- level of protection and conservation in a fiscally constrained environment.

Government priorities

The Government's priority is the conservation of natural and historic heritage whilst encouraging the development of appropriate recreation, tourism and other commercial opportunities.

Defence



PPE managed by the New Zealand Defence Force (NZDF) as at 30 June 2010

\$1 billion investment in new helicopters over the next three years

\$6 billion asset replacements between 2020 and 2030

- Provides national security outcomes
- Prioritisation of depreciation funding required for asset replacement post-2020
- Must remain interoperable with international partners

Description

NZDF is responsible for securing New Zealand against external threats, protecting our sovereign interests and being able to take action to meet likely contingencies in our strategic areas of interest, particularly that of the South Pacific region. To deliver on New Zealand's national security policy outcomes NZDF manages a range of military assets.

NZDF manages non-current assets totalling around \$5.3 billion including:

- specialist military equipment (\$3.3 billion); for example, ships, aircraft, weapons systems and armoured vehicles, and
- land and buildings (\$1.8 billion).

The Ministry of Defence (MOD) and NZDF are jointly responsible for the through life management of assets.

Performance

Readiness to deploy is the key effectiveness measure in relation to specialist military equipment.

Actual and forecast NZDF PPE

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Total across |
|-----------------|--------|--------|--------|--------|----------|----------|----------|----------|----------|-----------------|
| (\$ million) | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast | forecast period |
| Opening balance | 3,888 | 3,715 | 4,957 | 5,483 | 5,297 | 5,368 | 5,409 | 5,329 | 5,076 | |
| Additions | 301 | 129 | 370 | 326 | 418 | 435 | 320 | 144 | 134 | 1,451 |
| Disposals | (39) | (26) | (32) | (19) | - | - | - | - | - | - |
| Revaluations | (170) | 505 | 455 | (155) | - | - | - | - | - | - |
| Depreciation | (288) | (275) | (300) | (337) | (347) | (394) | (400) | (397) | (394) | (1,932) |
| Other movements | 23 | 909 | 33 | (1) | - | - | - | - | - | - |
| Closing balance | 3,715 | 4,957 | 5,483 | 5,297 | 5,368 | 5,409 | 5,329 | 5,076 | 4,816 | |

Source: The Treasury

Risks and challenges

Investment in defence is often “lumpy” owing to infrequent large-scale costs. Prioritisation of the capital programme will be required given the gap between forecast depreciation funding and the forecast capital intentions articulated in the Defence White Paper. In particular New Zealand will face defence capability investment pressures of approximately \$6 billion during the period 2020 to 2030, when several of the following major assets reach the end of their operating life:

- C130 Hercules transport aircraft
- P3 Orion maritime surveillance aircraft, and
- Naval combat ships.

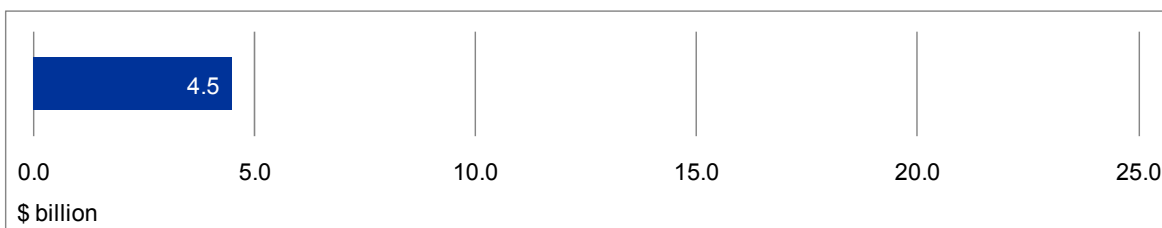
Government priorities

The Defence White Paper (November 2010)¹³ sets the direction for the replacement of NZDF capabilities over the next 25 years. By international standards, NZDF is a small defence force and historically New Zealand has deployed overseas as part of a coalition force. This requires that NZDF remains interoperable with its key strategic partners and this consequently will affect investment decisions.

Future capabilities will be prioritised and alternative ownership models will be assessed as assets come up for replacement. Fleet mixes and operating implications of assets will also be considered. Base consolidation and divestment of housing stock are opportunities that have been identified to rationalise the stock of land and buildings.

¹³ <http://www.beehive.govt.nz/feature/defence+white+paper+2010+12>

Healthcare



PPE managed by District Health Boards (DHBs) as at 30 June 2010

5 major hospitals,
20 general hospitals and
over **50** smaller facilities

- Provides a wide range of health services
- Income growth and technological change are the main health spending drivers with demographic factors of secondary importance
- Increasing emphasis on community settings for services

Description

The New Zealand health and disability system aims to achieve better health for all New Zealanders. Twenty DHBs are responsible for the delivery of government-funded healthcare. DHB assets include:

- Five major hospitals in Auckland, Hamilton, Wellington, Christchurch and Dunedin
- 20 general hospitals, and
- at least 50 smaller facilities made up of day surgery facilities, geriatric units, birthing facilities, primary care facilities and sites with a mixture of these facilities.

The Government maintains control over large investment decisions, while DHBs make decisions on smaller investments.

Most primary care assets are not on the Crown balance sheet and are owned by self-employed General Practitioners or corporate entities. These entities fund capital investment through private equity and/or debt and generate operating revenue through government subsidies and patient charges.

Performance

DHBs' main capital performance measure is revenue to fixed asset ratios where lower ratios of fixed assets to revenue are preferred. This metric is potentially affected by differences in capital intensity for different hospital types and by land values and asset age. For the March 2010 quarter, the ratios ranged from 2.7 for South Canterbury DHB to 0.88 for Capital & Coast DHB with an average of 1.7.

Actual and forecast Ministry of Health PPE

| (\$ million) | 2007 Actual | 2008 Actual | 2009 Actual | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | Total across forecast period |
|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|---------------------------------|
| Opening balance | 3,733 | 3,969 | 4,192 | 4,381 | 4,469 | 4,979 | 5,448 | 5,656 | 5,675 | |
| Additions | 451 | 390 | 665 | 528 | 798 | 750 | 547 | 395 | 442 | 2,932 |
| Disposals | (57) | (138) | (55) | (44) | (33) | 10 | 13 | - | (65) | (75) |
| Revaluations | - | 146 | (51) | (92) | - | - | - | - | - | - |
| Depreciation | (254) | (274) | (280) | (304) | (330) | (348) | (377) | (377) | (377) | (1,809) |
| Other movements | 96 | 99 | (90) | - | 74 | 57 | 26 | - | - | 157 |
| Closing balance | 3,969 | 4,192 | 4,381 | 4,469 | 4,979 | 5,448 | 5,656 | 5,675 | 5,675 | |

Source: The Treasury

The sector also monitors asset utilisation through indirect measures such as average length of stay, day surgery rates and day of surgery admission. The current variability between the best and worst performing DHBs on these measures, as well as the gap with international best practice, indicates considerable scope for more efficient asset utilisation.

Risks and challenges

Health capital spending is driven by improvements in health technology, demographic changes (the ageing population as well as regional differences in population growth), models of care, and the age and condition of long-lived assets.

The sector is facing significant clinical and financial sustainability challenges looking forward. A key challenge is managing the demand for, and the cost of supplying, health care within the parameters of New Zealand's lower affordable level of spending per capita than wealthier countries. Ultimately, this will require further innovation in service delivery and/or choices around the level of service provision.

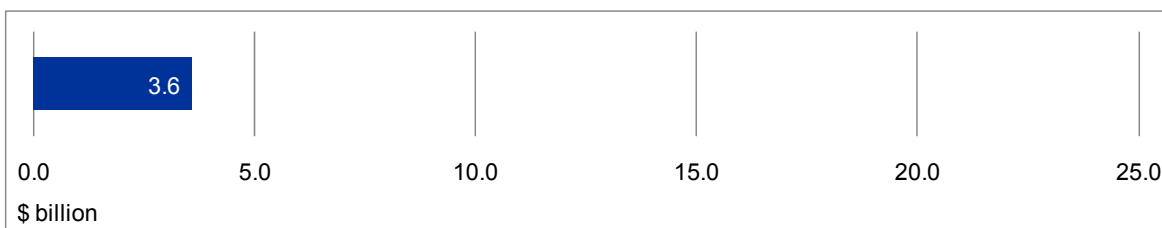
The main benefit of improved capital spending decisions will be through their contribution to smarter (better quality, more cost-effective, sustainable) service configurations and lower operational spending growth.

Government priorities

The Government's focus is on ensuring that DHBs find efficiencies so that they live within their means and improve value for money for taxpayers. This requires the sector to make significant productivity and quality improvements. To support these improvements, Government's priorities include:

- The new National Health Board and moves to strengthen regional and national coordination of selected services by DHBs will lead to reconfiguration of services and assets that are intended to improve the financial and clinical sustainability (and efficiency) of health services.
- Shared services initiatives, including those led by the new Crown company Health Benefits Limited, should improve procurement practices and the configuration of support services infrastructure and facilities management.
- The introduction of Integrated Family Health Centres (IFHCs) aims to provide more services closer to the community through primary care. This may reduce pressure on DHBs' secondary care and rural facilities and thus the scale of Crown investment in these assets. IFHCs are intended to be privately owned and financed.
- The introduction of a more rigorous national capital planning process, under the new Capital Investment Committee, aims to aid better sector-wide decision-making and capital allocation in the health sector.

Justice



PPE managed by the Ministry of Justice, Department of Corrections and New Zealand Police as at 30 June 2010

20 prisons,
247 courtrooms and
3,100 police cars

- Law enforcement and crime prevention
- Growing prison population
- Whole-of-sector planning and investment required

Description

The Justice sector provides for the delivery of law enforcement functions, court services and secure containment and management of offenders.

- The Department of Corrections has assets with a carrying value of \$2.03 billion. It owns and operates 20 prisons containing 9,881 beds. It also owns 49 Probation Offices and leases another 102. These, along with software, forestry and 1,440 vehicles make up 98% of the Department's assets.
- The Ministry of Justice operates 247 courtrooms across the country supported by a range of information and technology solutions. The Ministry also owns motor vehicles and court security equipment. The book value of these assets was \$642 million at 30 June 2010.
- The New Zealand Police owns 604 stations and buildings, 3,100 police cars, a range of computer applications and hardware, a nationwide radio network, and radar and weaponry equipment with a total carrying value of \$958 million. Of this total, \$736 million is in land and buildings.

Performance

There are limited measures of the effectiveness of the current investment in Justice sector assets.

The Ministry of Justice ensures that 100% of courtrooms are available during court operating hours. Courtroom utilisation is measured by comparing the possible number of days a room is available compared with actual days the room has been used.

The New Zealand Police has some asset-specific measures such as network and application availability and issue resolution. Key asset performance indicators monitored by Police include property condition and utilisation, and vehicle utilisation, and network and application availability and issue resolution.

New Zealand Police currently achieves around 23 square metres per full-time equivalent (FTE) across station and office property, and 15 square metres per FTE in office-type accommodation. Vehicles travel approximately 28,500 kms per annum on average, up

from 27,000 kms two years ago. Police continues to refine asset performance information, with a view to improving value for money from the asset base.

Minimising whole-of-life cost is a consistent focus across the Justice sector asset portfolios.

Actual and forecast Department of Corrections PPE

| (\$ million) | 2007 Actual | 2008 Actual | 2009 Actual | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | Total across forecast period |
|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|---------------------------------|
| Opening balance | 1,311 | 1,728 | 1,698 | 1,941 | 2,028 | 2,145 | 2,215 | 2,170 | 2,106 | - |
| Additions | 301 | 80 | 117 | 207 | 238 | 199 | 90 | 71 | 67 | 665 |
| Disposals | (5) | (8) | (6) | (3) | (4) | (2) | (2) | (2) | (2) | (12) |
| Revaluations | 191 | - | 244 | - | - | - | - | - | - | - |
| Depreciation | (68) | (108) | (116) | (119) | (116) | (128) | (133) | (133) | (123) | (633) |
| Other movements | (2) | 6 | 4 | 1 | - | - | - | - | - | - |
| Closing balance | 1,728 | 1,698 | 1,941 | 2,028 | 2,145 | 2,215 | 2,170 | 2,106 | 2,049 | - |

Source: The Treasury

Actual and forecast New Zealand Police PPE

| (\$ million) | 2007 Actual | 2008 Actual | 2009 Actual | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | Total across forecast period |
|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|---------------------------------|
| Opening balance | 537 | 568 | 609 | 916 | 923 | 972 | 1,019 | 1,046 | 1,073 | - |
| Additions | 23 | 97 | 105 | 85 | 113 | 111 | 92 | 92 | 73 | 481 |
| Disposals | (15) | (15) | (131) | (17) | (1) | (1) | (1) | (1) | (1) | (5) |
| Revaluations | 21 | - | 264 | - | - | - | - | - | - | - |
| Depreciation | (46) | (52) | (55) | (61) | (63) | (63) | (64) | (64) | (64) | (318) |
| Other movements | 48 | 11 | 124 | - | - | - | - | - | - | - |
| Closing balance | 568 | 609 | 916 | 923 | 972 | 1,019 | 1,046 | 1,073 | 1,081 | - |

Source: The Treasury

Actual and forecast Ministry of Justice PPE

| (\$ million) | 2007 Actual | 2008 Actual | 2009 Actual | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | Total across forecast period |
|-----------------|----------------|----------------|----------------|----------------|------------------|------------------|------------------|------------------|------------------|---------------------------------|
| Opening balance | 417 | 438 | 507 | 579 | 618 | 635 | 635 | 647 | 672 | - |
| Additions | 47 | 61 | 112 | 79 | 61 | 46 | 59 | 76 | 66 | 308 |
| Disposals | (3) | (1) | (10) | (1) | - | - | - | - | - | - |
| Revaluations | 32 | 43 | 1 | (22) | - | - | - | - | - | - |
| Depreciation | (30) | (36) | (40) | (41) | (44) | (45) | (47) | (50) | (50) | (236) |
| Other movements | (25) | 2 | 9 | 25 | - | - | - | - | - | - |
| Closing balance | 438 | 507 | 579 | 618 | 635 | 635 | 647 | 672 | 687 | - |

Source: The Treasury

Risks and challenges

New Zealand has a changing, diverse and ageing prison population, with long lead times to resolve capacity challenges in the face of increasing demand, and an ageing prison stock. The network of courthouses and police stations is widely dispersed, driving increasing operating costs.

Over the medium term the biggest challenge facing the Justice sector is to plan for an efficient, fit for purpose and coordinated network of police stations, court houses and jails, in the context of a northward drifting population and tighter fiscal constraints.

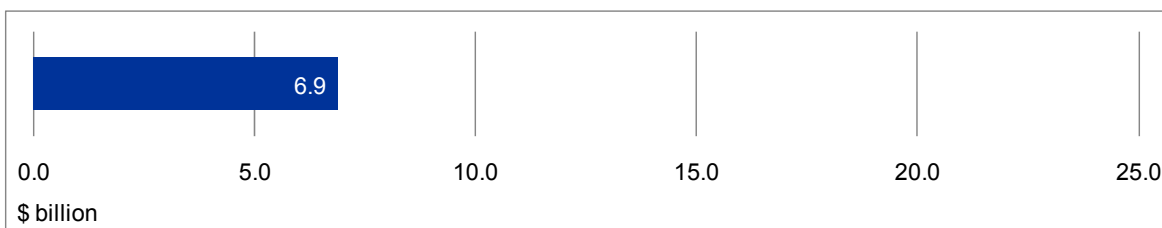
Government priorities

The Government has identified a number of priorities for the Justice sector, including competitive tendering of prisons, ensuring adequate prison capacity and improving efficiency across the sector.

A particularly significant initiative is a new large prison the Department of Corrections is planning at Wiri, to be implemented as a PPP and expected to deliver innovation across the Department's asset portfolio.

Current property projects in the Ministry of Justice, such as Auckland District Court redevelopment and creation of a specialist courts facility in Auckland, will improve courtroom utilisation by promoting sharing of assets across court jurisdictions.

Tax receivables



Asset: \$10.8 billion (impairment of \$3.9 billion) as at 30 June 2010

47% of total receivables are overdue, owed by **363,814** taxpayers

32% of overdue receivables are deemed non-collectable

- Tax revenue funds government expenditure
- Debt growth is affected by economic conditions
- Review of debt and tax return management practices commenced

Description

Tax revenue is collected to fund government expenditure. Tax receivables represent outstanding debt due to the government relating to:

- tax obligations
- overpaid Working for Families Tax Credits
- KiwiSaver contributions
- interest, and
- penalties accrued.

Tax receivables most often arise when a tax assessment has been issued by Inland Revenue, but payment has not yet been received.

Performance

While tax debt is growing at a rate that is outpacing Inland Revenue's capacity to deal with it, most people pay their tax on time and meet all of their obligations.

Inland Revenue has the following output performance measures to manage tax receivables in 2010/11:

| | 2009/10 Actual | 2010/11 Target |
|---|-------------------|-------------------|
| Number of debt cases by year-end | 510,980 | 505,000 |
| Percentage of collectable debt value over two years old | - | <33% |
| Percentage of new debt cases resolved within: | | |
| – three months | - | 66% |
| – 12 months | - | 85% |
| of the due date for payment | | |
| Cash collected for every debt output dollar spent | \$52.15 | \$50.00 |

Tax debt grew steadily between 2004 and 2007, although growth has slowed and is forecast to decline.

Actual and forecast tax receivables

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|-----------------|--------|--------|--------|--------|----------|----------|----------|----------|----------|
| (\$ million) | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| Tax receivables | 7,575 | 7,398 | 7,649 | 6,864 | 6,214 | 5,862 | 5,447 | 5,152 | 4,905 |
| % annual change | | -2.3 | 3.4 | -10.3 | -9.5 | -5.7 | -7.1 | -5.4 | -4.8 |

Source: The Treasury

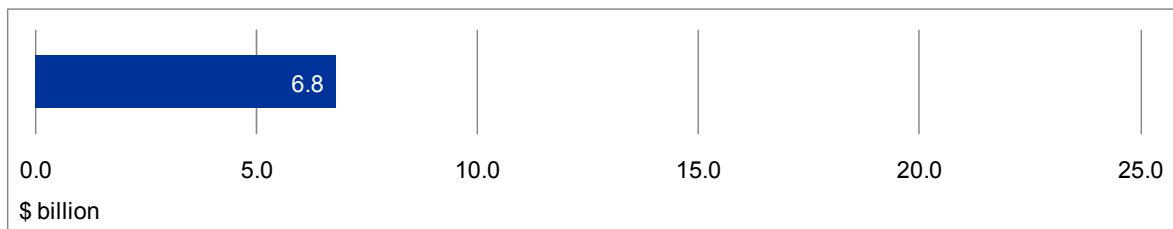
Risks and challenges

Growth in the level of debt is the key challenge in managing tax receivables. Debt growth is reflective of the economy, and will be affected by the recent recession. In 2008 Inland Revenue predicted that tax debt could more than double within five years unless it took a fresh approach to managing debt.

Government priorities

Inland Revenue is updating its debt and return management practices covering key processes and systems to respond to the challenges it faces. It is proposing to provide taxpayers with improved online tools, and pilot new approaches to improve processes for collecting tax debt.

Student loans



Asset: \$11.1 billion nominal value, write-down and impairment of \$4.3 billion as at 30 June 2010

43 cents in every \$1 effective subsidy rate for the 2009/10 year

\$16,213 average loan size

85% of loans are under \$30,000

- Provides access to finance for study for tertiary students
- Asset write-down is high, reflecting repayment regime and interest free
- Performance focus is on governance

Description

The Student Loan Scheme facilitates access to tertiary education. Between 1992 and 2010, 894,000 students used the Student Loan Scheme, borrowing more than \$13.9 billion. The scheme has undergone numerous policy changes over the past decade, with the most significant being the introduction of interest free loans. The carrying value of student loans in the Crown accounts is significantly below the nominal value of the loans, largely owing to the interest free loans and income contingent repayment policies.

The scheme is primarily administered by three government agencies:

- Ministry of Education – policy advice and lead responsibility for the scheme overall
- Ministry of Social Development – information, assessment and payment, and
- Inland Revenue – loan management and collection.

Performance

Participation rates in tertiary education have increased over the past decade and overall numbers have risen significantly. The loan scheme is one factor affecting this.

Eighty-five percent of student loans are under \$30,000 and 75% of New Zealand-based borrowers pay off their loans within 7.5 years. Repayment compliance by New Zealand-based borrowers is generally high. However, compliance remains poor for those based overseas with overdue repayments increasing by 60% to \$182 million between 2009 and 2010.

Around half of all current student loan borrowers do not have a repayment obligation as they either earn under the repayment threshold, are current students or are overseas on temporary repayment holidays.

Actual and forecast student loans values

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Total across |
|--------------------|--------|--------|--------|--------|----------|----------|----------|----------|----------|-----------------|
| (\$ million) | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast | forecast period |
| Opening balance | 5,569 | 6,011 | 6,741 | 6,553 | 6,790 | 7,239 | 7,641 | 7,964 | 8,218 | |
| New loans | 1,176 | 1,201 | 1,350 | 1,525 | 1,547 | 1,558 | 1,580 | 1,602 | 1,622 | 7,909 |
| Initial write-down | (488) | (487) | (532) | (728) | (706) | (711) | (720) | (730) | (739) | (3,606) |
| Loans repayments | (555) | (629) | (710) | (754) | (791) | (878) | (997) | (1,101) | (1,213) | (4,980) |
| Other movements | 309 | 645 | (296) | 194 | 399 | 433 | 460 | 483 | 511 | 2,286 |
| Closing balance | 6,011 | 6,741 | 6,553 | 6,790 | 7,239 | 7,641 | 7,964 | 8,218 | 8,399 | |

Source: The Treasury

The “other movements” line in the table above reflects loan revaluations that occur owing to changes in the time value of money and the maturity profile of the loan book, impairments or the reversal of impairments and other elements such as administration fees charged to those taking out loans.

Risks and challenges

Managing the significant cost of the Student Loan Scheme remains an ongoing challenge. Government agencies face difficulties in predicting future repayments, and this has been reflected in valuation volatility. Valuation is sensitive to assumptions such as borrowers’ future income, repayment behaviour of borrowers, the unemployment levels of borrowers and economic factors, such as salary inflation and the consumer price index.

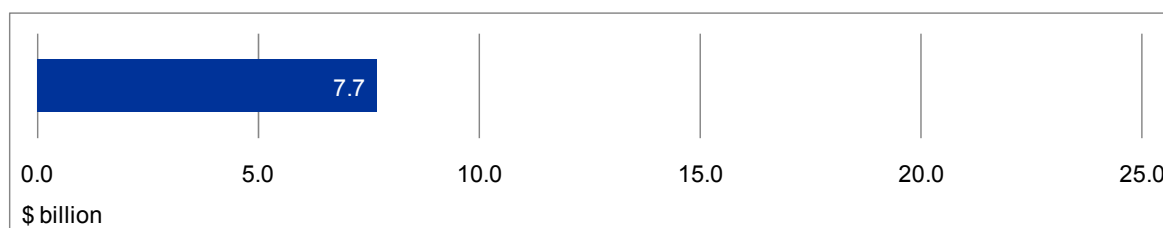
There is also an ongoing challenge to improve the compliance of overseas-based borrowers. The first wave of overseas-based borrowers on repayment holidays are now coming off these holidays. There is a challenge in ensuring that these borrowers meet their new repayment obligations.

Scope could exist for greater private sector involvement in student loans in the medium term. Some countries, such as the US, rely more on the private sector to deliver finance for tertiary education.

Government priorities

The Government is looking to ensure that this complex and growing asset is governed appropriately and to improve repayment compliance by overseas-based borrowers.

Tertiary Education Institutions



Equity accounted investment as at 30 June 2010

20 polytechnics, **8** universities and **3** wānanga
\$4 billion in total annual revenue
 Over **200,000** domestic full-time students

- Provision of tertiary education
- Lack of centrally held asset information
- New asset transfer policy to encourage better balance sheet management

Description

There are 31 universities, institutes of technology and polytechnics (ITPs) and wānanga in New Zealand, which collectively constitute the TEIs. Approximately half of the revenue of TEIs is from government funding, with the remaining coming from sources such as domestic student fees, international students and research income.

TEIs are Crown entities and the Government has a number of legislative powers over them in the interests of public accountability, including significant reserve controls in the event of an institution facing risk. The applicability of the test for consolidation of TEIs in the Crown's accounts is unclear, and is still under consideration by relevant accounting authorities. In the interim, the TEIs are included in the Government's financial statements as a 100% equity accounted investment.

Performance

The Government expects TEIs to efficiently manage their assets and fund new capital expenditure from their balance sheet and/or from borrowing, rather than specific capital injections funded directly. A financial monitoring framework incorporating financial viability and sustainability ratios was implemented in 2009 and will include specific asset performance measures for the tertiary sector in the future.

Actual and forecast carrying value of TEIs

| | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
|-----------------|--------|--------|--------|--------|----------|----------|----------|----------|----------|
| (\$ million) | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| TEIs | 6,305 | 7,037 | 7,417 | 7,740 | 7,972 | 8,198 | 8,404 | 8,609 | 8,814 |
| % annual change | | 11.6 | 5.4 | 4.4 | 3.0 | 2.8 | 2.5 | 2.4 | 2.4 |

Source: The Treasury

Risks and challenges

There are ongoing financial viability issues within some TEIs, with the Crown carrying the residual risk. There is also a lack of centrally held information about TEI assets.

Government priorities

The tertiary education sector is developing a capital asset management framework to encourage best practice by TEIs which should improve centrally held asset information.

The Government expects the TEI sector to be financially sustainable and deliver quality tertiary education. The Government has announced an asset transfer policy that will allow TEIs to seek transfer or disposal of Crown-owned assets that they manage. This is to encourage TEIs to better manage their balance sheets and maintain their assets.

High-level choices in the social asset portfolio

Any government faces a set of high-level strategic choices that can be applied to different parts of the social asset portfolio.

The purpose of investment of capital in social assets is to deliver priority services as effectively and efficiently as possible. To achieve this, the Government needs to set high-level priorities, and agencies need to establish and update longer term demand projections and capital asset planning based on reasonable funding parameters. Finding better ways of revealing and comparing the value of different investments within and across agencies, so that best value investment decisions can then be made amongst competing priorities, is also essential.

This requires decision-making to be based on more rigorous and transparent choices around the optimal price, quantity and standard of services, with procurement choices based on whole-of-life value and recognising the full cost of capital. Investment decisions also need to be followed up with more systematic review to establish whether the Government's expectations were achieved, as well as more transparent performance objectives and reporting.

Within this general framework, investment in social assets will depend on a number of choices. Policy and operational decisions impact on the *demand* for public services, the extent of public provision and contestability of supply, and the operating model and *productivity* of public service delivery, which in turn affect the demand for assets, the efficiency of asset use and the quality of assets.

Objectives and priorities: Government's social objectives and policy priorities influence what services the Government will fund, and the extent to which assets are required in pursuit of those services. For example, the objective of providing reasonable access to healthcare for all New Zealanders and the decision to fund some health services means that some health assets are necessary (whether they are privately owned or government owned). Likewise, the objective of removing financial barriers to tertiary education through providing access to finance for study is the rationale behind student loan schemes. Governments have different objectives (*goals*), and make different policy choices about the best way of achieving those objectives (the *means*).

Demand levels: Within areas which the Government is committed to funding, policy settings affect the demand for assets. For example, increasing the minimum prison term for criminal convictions increases the demand for prison cells and increasing the leaving age for compulsory education increases the demand for schooling space.

Intensity of utilisation: Policy choices can affect the intensity of asset utilisation and subsequently affect overall demand levels. For example, choices around maximum class sizes and the appropriateness of double bunking in prisons affect asset utilisation and can either increase or decrease demand and the cost of services.

Asset quality: A choice exists as to the quality of assets provided. Typical considerations include:

- variations in the initial cost and ongoing maintenance costs incurred, and
- whether the marginal costs of increased asset quality generate sufficient marginal benefits to justify additional cost.

Decisions on quality are made both at the initial point of investment, and by agreement to particular policy or operational settings which guide ongoing investment, such as whether certain types of roads should be shingle or tarmac, or the level of heating and insulation provided in class rooms.

“Make or buy” and procurement options: The Government can achieve its policy objectives by providing services itself or by contracting with third parties to deliver services. A mixture of approaches is taken currently, but in many areas there is limited contestability of supply. For example:

- wholly or largely government provided – state schooling and student loans
- wholly provided by third parties – early childhood education and aged residential care, and
- mixed – hospital services (where some publicly-funded hospital services are provided by private hospitals) and state housing (where it owns the majority of houses but leases a small portion).

Owning assets reduces the availability of capital for other items on the balance sheet and the extent to which private sector asset management disciplines can be harnessed. However, where government chooses to fund services from third party providers, ongoing operating costs may be higher to reflect private providers’ cost of capital – but this does not necessarily mean that government provision is more cost-effective or cheaper as the Crown’s cost of capital also needs to be fully recognised.

Financial assets and liabilities¹⁴

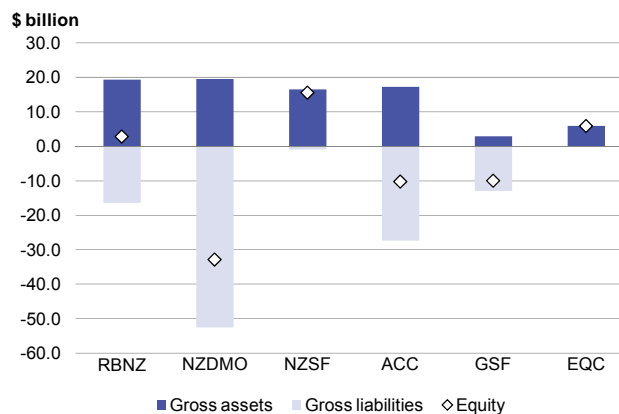
Introduction

Purpose

As part of prudent fiscal management, a number of mechanisms have been established to provide for future known or anticipated Crown liabilities and expected expenditure. Collectively these mechanisms comprise:

- a portfolio of funds under management (FUM) and specific associated liabilities, namely future fiscal pressures from an ageing population, personal accidents, natural disasters and defined benefit pension schemes (NZSF, ACC, EQC, GSF, NPF – collectively the “Crown Financial Institutions”, or CFIs)¹⁵
- borrowing to finance the Government’s cash requirements, with associated assets held for liquidity purposes (NZDMO), and
- New Zealand’s central bank, with a range of assets and liabilities for financial system liquidity management and crisis intervention capability (RBNZ).

Figure 14 – Major financial assets and liabilities as at 30 June 2010



Source: The Treasury

Current holdings

The financial assets are a sizeable part of the Crown’s balance sheet. Their performance will have a significant impact on the Crown’s ability to manage future challenges including known liabilities, economic shocks and natural disasters.

It is important, therefore, to consider their individual performance but also their collective performance. The Crown, and hence the taxpayer, bears the risk to the extent that any of the funds or entities underperform in managing the assets and/or the liabilities they cover. In addition, the residual liability of the portfolio lies with the Crown, and hence the taxpayer.¹⁶

The following table outlines the purpose and descriptions of the various assets and liabilities and their net worth (as at 30 June 2010 and based on the Government’s Financial Statements, ie, with transactions between entities eliminated).

¹⁴ For the purposes of the Financial Statements of the Government any transactions between entities within the Crown reporting group are eliminated. However, the entity-specific reporting in this section includes transactions made to entities within the Crown reporting group, so reported numbers will differ.

¹⁵ NPF schemes are managed and administered by a Trust, while the Crown is the guarantor of the benefits payable by the schemes. Because of this NPF is included in the section on “Provisions and contingencies”.

¹⁶ COMU Annual Portfolio Report 2010 (APR).

| | Entity | Purpose | Assets | Liabilities | Net worth |
|------------------------------|---|---|--|---|------------------|
| Crown Financial Institutions | New Zealand Superannuation Fund (NZSF) | To part fund future New Zealand Superannuation (NZS) (NZSF is intended to help meet the future fiscal pressure on New Zealand Superannuation from an ageing population) | \$15.9 billion Risk profile: long-term, growth assets Mainly active management of portfolio of largely equities and other growth assets. Sizeable NZ portfolio. | (\$0.8 billion) This liability represents obligations in relation to NZSF's investing activities. There is no liability recognised in relation to meeting any future NZS payments. | \$15.1b |
| | Accident Compensation Corporation (ACC) | To recognise the future obligation to provide personal injury cover, and to hold assets to fund that obligation | \$13.7 billion Risk profile: mixture of short-term and long-term Mixture of cash (for short-term) and bonds/equities/growth assets (for longer term). Mix of NZ/offshore assets. | (\$27.3 billion) Obligation to provide injury cover for accidents already incurred. | (\$13.6b) |
| | Earthquake Commission (EQC) | To hold assets to help meet the cost of a major earthquake or other natural catastrophe | \$1.9 billion Risk profile: low risk Mainly government bonds, and some cash/equities. | (\$0.1 billion) Obligation to meet the costs of natural disaster claims in the event of a catastrophe. | \$1.8b |
| | Government Superannuation Fund (GSF) | To recognise the defined benefit pension scheme, and to hold assets to fund that obligation | Risk profile: medium risk Mixture of growth assets and cash/fixed interest assets. | (\$10 billion) (net liability: \$12.9 billion liability offset by \$2.9 billion in assets) Obligation to meet the historical public sector pension scheme. | (\$10b) |
| Borrowing | NZ Debt Management office (NZDMO) | To fund the Government's expenditure | \$5.7 billion Risk profile: low risk Mainly fixed interest, liquid assets to provide liquidity. | (\$41 billion) ¹⁷ Government bonds and Treasury bills issued to finance current/past expenditure. | (\$35.3b) |
| Central Bank | Reserve Bank of New Zealand (RBNZ) | To manage financial/monetary system | \$22.8 billion Risk profile: medium risk | (\$13.4 billion) Primarily deposits from financial institutions and the Government; and currency in circulation. | \$9.4b |
| | Portfolio total¹⁸ | | \$60b | (\$92.6b) | (\$32.6b) |

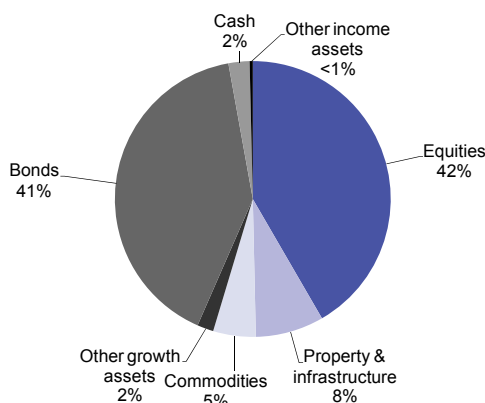
Source: The Treasury

¹⁷ This figure includes liabilities incurred to support the provision of social assets as most of these are managed centrally by NZDMO.

¹⁸ Transactions between entities have been eliminated in this table and so do not match the figures given for each entity in the entity-by-entity discussion in the remainder of this section.

The majority of the CFI portfolio is held in growth assets, with the remainder in bonds or cash. While these choices are made by the individual fund managers, the aggregate results are useful in understanding the Crown's overall risk exposure.¹⁹

Figure 15 – CFI portfolio asset allocation



Source: COMU APR

Summary performance measures

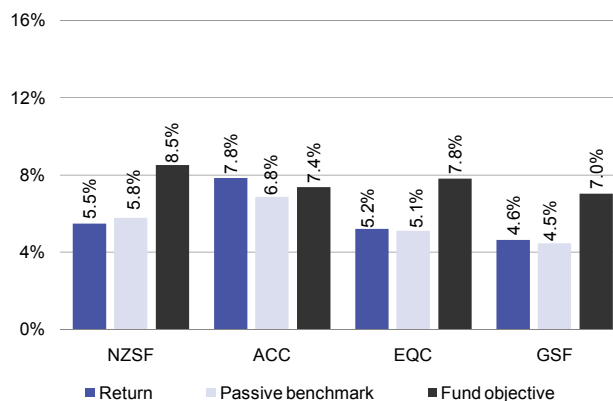
The performance of the CFIs is outlined in the *COMU Annual Portfolio Report 2010 (APR)*.

Simply put, the objective of each investment fund is to minimise the amount tomorrow's taxpayers will pay to meet the Crown's obligations. To do this successfully, the investment approach of each fund needs to be matched to the nature of those obligations. For example, EQC needs to invest in such a way that it can quickly liquidate investments in the event of a disaster. In contrast, NZSF was established to meet an expected peak in superannuation payments around 2025. It can therefore take longer positions and invest in less liquid assets.²⁰

The five CFIs all have different objectives, risk profiles and associated liabilities. They therefore also pursue different investment strategies which makes comparing performance within the portfolio challenging.

Nevertheless, some cross-portfolio comparisons are possible. Figure 16 shows the investment performance of the funds under management for the five CFIs since 2001.²¹ The three bars indicate:

Figure 16 – CFI long-term returns



Source: The Treasury
(Return periods are as follows: NZSF from Sept 2003, ACC from June 2001, EQC from Dec 2003, GSF from Dec 2001)

- actual returns, measured *before* tax but *after* fund management fees

¹⁹ COMU APR.

²⁰ COMU APR.

²¹ Important caveats are that, first, these returns are over the period of extreme financial market volatility, and different timeframes show different results (eg, NZSF was comfortably exceeding its Fund's objective prior to the global financial crisis). Second, many of the funds have long-term horizons, so the appropriate final metric could be in 10 years' time (although they should outperform the passive benchmark in the short term).

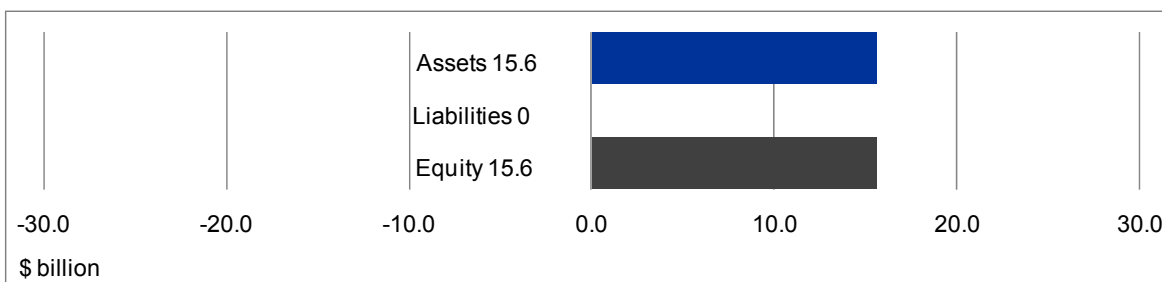
- returns against a passive benchmark or reference portfolio – this provides a comparison for what a portfolio of assets with the same risk profile tracking a simple index would have achieved,²² and
- the Fund's objective.

All of the funds are showing positive returns over this period. However, only the ACC fund has been able to consistently beat its passive benchmarks.²³

²² The passive benchmark/reference portfolio is therefore different for the different funds.

²³ For a more detailed discussion of performance metrics see COMU APR.

New Zealand Superannuation Fund



19% in New Zealand assets (31% including cash and bonds)

3% gap between returns and the Fund's objective

Withdrawals from the Fund scheduled to begin in **2031**

- Builds up assets to part fund future New Zealand Superannuation
- Investment performance has been below passive benchmark, but the investment horizon is long term
- Government contributions will resume on return to surplus

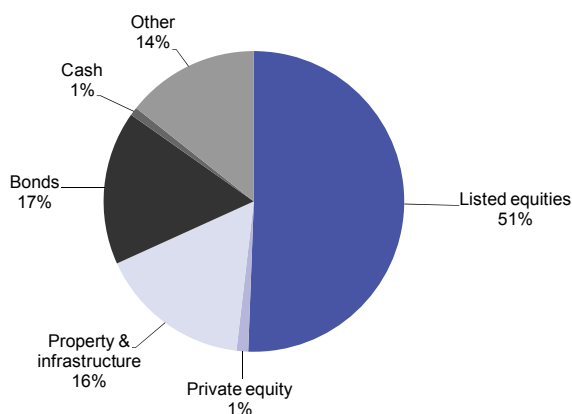
Description

NZSF pre-funds part of the future cost of New Zealand Superannuation, by investing government contributions and the returns on that investment over the long term. By doing so, the Fund smooths the tax burden of the cost of New Zealand Superannuation between generations of New Zealanders. The Fund is managed by an autonomous Crown entity, the Guardians of New Zealand Superannuation.

Composition and performance

NZSF has a duty to invest on a commercial, prudent basis and holds mainly growth assets like property and shares. These assets provide wide diversification and are expected to generate returns in excess of a portfolio of Treasury bills. The Fund is managed on an active basis, meaning fund managers are employed to outperform relevant market benchmarks, such as the NZ Equity Market Index.

Figure 17 – NZSF asset allocation



The composition of the Fund is shown in Figure 17.

Source: The Treasury

The Government's view is that it is in the national interest for the Fund to have significant investments in New Zealand. In May 2009 the Government therefore directed the Guardians to note its expectation that opportunities to increase the allocation of New Zealand assets in the Fund should be identified and considered, consistent with the Fund's duty to invest on a commercial, prudent basis.

As at 30 June 2010 around \$2.7 billion (about 19%) of the Fund is invested in New Zealand (this figure is about 31% including cash and bonds).

Figure 19 below shows investment performance. Compound annual returns since inception have not met the Guardians' objective of outperforming an equivalent passive portfolio. It is also not achieving its long-term expectation of outperforming Treasury bills plus 2.5%.

Risks and challenges

The prices of growth assets are highly volatile. While diversification mitigates this risk to some extent, there are times when returns may be severely impacted over a year or a few years. The global financial crisis was one such event.

The Fund is investing into non-listed assets more, which have risks of lower transparency and liquidity, and are significantly more expensive to manage than listed equities. The Guardians expect that higher expected returns from these investments should adequately compensate the Fund for the greater uncertainty.

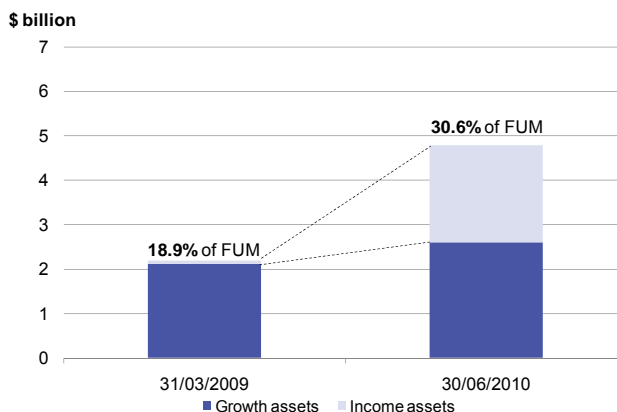
The Guardians continually review their investment strategies, and remain confident that their active investment strategy is appropriate.

Government priorities

The Government has suspended contributions to the Fund for a period while the annual operating balance remains in deficit. Once sufficient operating surpluses return, the Government intends to contribute the amount required by the Fund formula. When contributions begin again, this required contribution will be higher than it would have been without the temporary suspension of contributions.

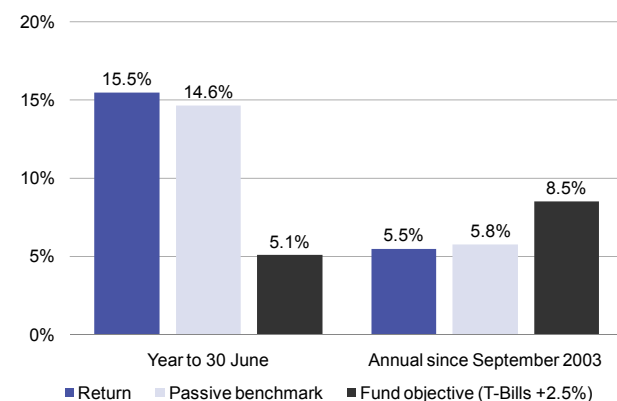
The priorities for the Fund remain maximising the return from its assets without incurring undue risk for the Fund as a whole, and avoiding prejudice to New Zealand's reputation.

Figure 18 – New Zealand assets



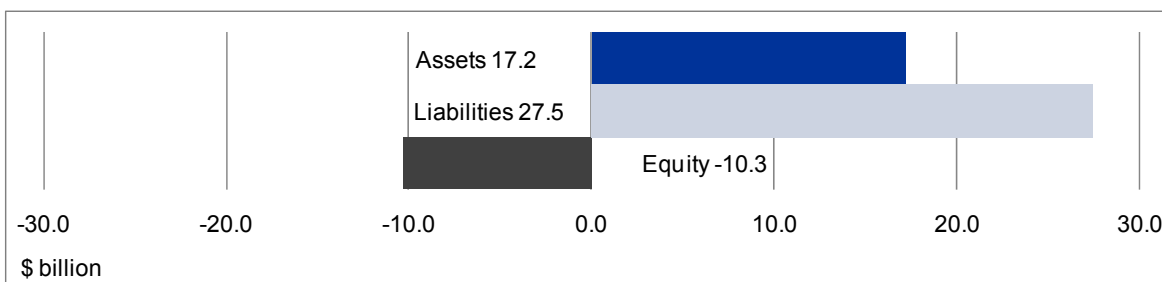
Source: The Treasury

Figure 19 – NZSF returns



Source: The Treasury

Accident Compensation Corporation



1.7% excess return over a passive benchmark since 2001

\$10.3 billion unfunded liability at 30 June 2010

9 years to being fully funded

- Represents the obligation to provide personal injury cover, and assets to fund that obligation
- Asset performance has been good, while liability has increased rapidly but now stabilised
- On track to be fully funded by 2019

Description

The Accident Compensation scheme, managed by ACC, provides comprehensive no-fault personal injury cover for all New Zealand residents and visitors. The liabilities represent an estimate of the future cost of claims for injuries already incurred. The assets are largely levies collected and reinvested to fund the future cost of claims.²⁴

Since 1999 (or 2001 in the Non-Earners' Account), ACC has operated on a fully funded basis; that is, it collects sufficient levies to cover the lifetime costs of injuries occurring in that year. A residual levy is also collected to cover "legacy" costs of injuries that occurred between 1974 and 1999.

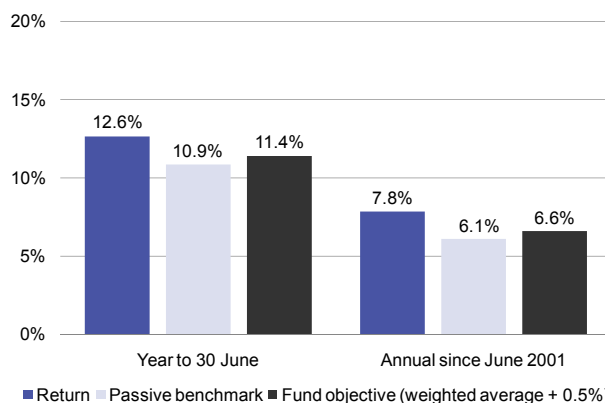
Performance

ACC has various accounts depending on the nature of the liability. Each account's investment funds are split between short-term cash portfolios, which are used to meet near-term expenditure requirements, and a longer term reserves portfolio, which is set aside to meet the future costs of existing claims. Just over half the reserves are invested in New Zealand and overseas bonds, and the rest a combination of New Zealand and overseas equities, cash reserves and property and infrastructure.

²⁴ Includes \$13.1 billion of funds under management. Liabilities include \$24.4 billion of outstanding claims liability.

ACC’s investment key performance indicators (KPIs) are for its returns to be 0.5% above weighted average market benchmark. Figure 20 shows ACC has consistently achieved this benchmark.

Figure 20 – ACC returns



Source: The Treasury

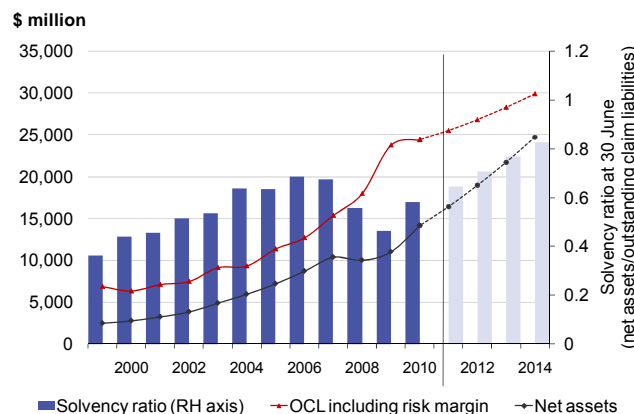
ACC’s liabilities increased \$14.4 billion between 2005 and 2009 through a combination of higher claim numbers, treatment and rehabilitation costs increasing more than anticipated, declining rehabilitation performance and accounting changes (adoption of IFRS). Performance has improved significantly in the last year, with a \$2.5 billion reduction in net liabilities. However, ACC’s asset base still remains well below its liabilities, as Figure 21 shows.

Risks and challenges

ACC is exposed to three general risks:

- economic and financial risks to its investments
- economic and financial risks to its liabilities (such as lower interest rates increasing the present value of all future liabilities), and
- a deterioration in scheme performance increasing liabilities (such as deterioration in rehabilitation rates, or excessive increases in healthcare cost).

Figure 21 – ACC’s net assets versus outstanding claims liability (OCL)



Source: ACC

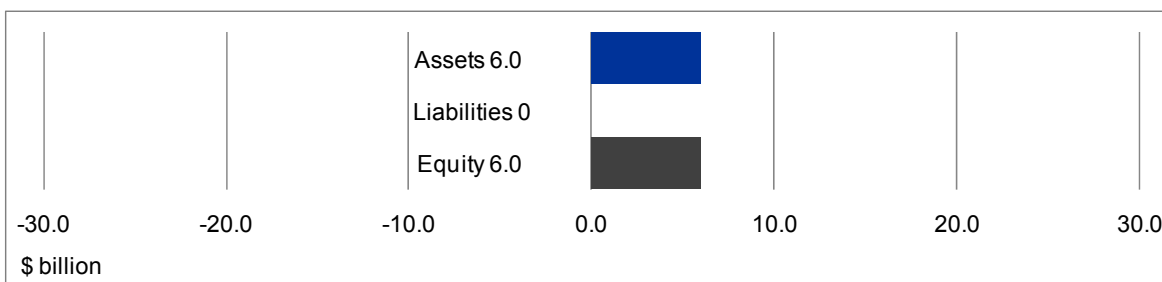
ACC has strategies in place to manage these risks, such as the choice of investment portfolio (for example, long-dated bonds to mitigate interest rate risk).

Government priorities

The Government’s balance sheet objective for ACC is to ensure the long-term financial sustainability of the scheme, while minimising levy volatility. That is, by 2019 when it is required to be fully funded, ACC should have sufficient assets to meet its liabilities for all claims.²⁵ The exception is liabilities for pre-2001 Non-Earners’ claims, which are funded on a pay-as-you-go basis – this accounts for \$3 billion of the unfunded liability at 30 June 2010.

²⁵ Note that the Government does not fund the risk margin in the Non-Earners’ Account, although risk margins are funded in the other accounts.

Earthquake Commission



115,000 claims received to date in relation to the Canterbury earthquake
\$1.5 billion likely reduction in the \$6 billion fund as a result of the earthquake

- Holds assets to help meet the costs of a natural catastrophe
- Moderate investment performance
- Canterbury earthquake claims are the current focus, while appropriate size and composition of the Fund will need to be assessed in light of the earthquake

Description

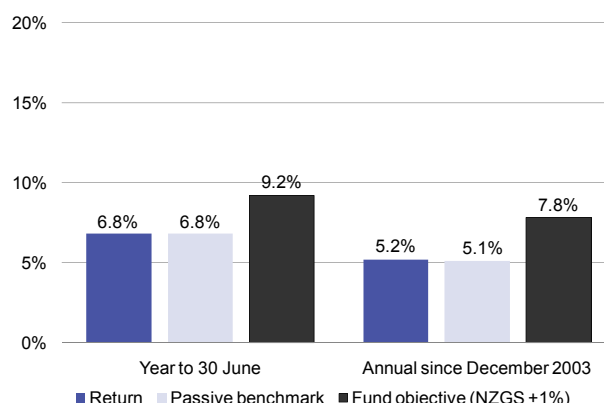
EQC is responsible for management of the Natural Disaster Fund (NDF), which is intended to help meet the costs to EQC of a major earthquake, or other natural catastrophe covered by the Commission, within New Zealand. EQC has a Crown guarantee; if the NDF was ever to be fully used up as the result of a natural disaster, the Crown would provide whatever further funding was required to settle claims against EQC.

Performance

Prior to the Canterbury earthquake the NDF had investments totalling around \$6 billion, invested in cash (\$0.3 billion), global equities (\$1.7 billion) and New Zealand government bonds (\$4 billion). EQC had also purchased \$2.5 billion of reinsurance cover.

As the Figure 22 shows, the investment performance of EQC's assets has largely matched passive benchmarks over time. The Fund's investment objective is to outperform the New Zealand Government Stock Index plus 1% over a rolling 10-year period.

Figure 22 – EQC returns



Source: The Treasury

Risks and challenges

For the Crown, the main balance sheet risks associated with EQC include having to make payments under the Crown guarantee, or having to borrow to redeem the NDF's investments in NZ Government bonds.

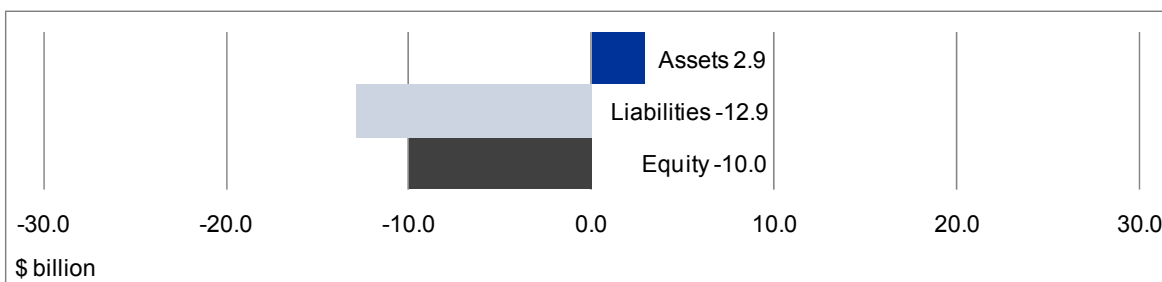
The appropriate size of the NDF is an important issue. Given the Crown guarantee, the NDF is effectively a form of pre-funding a contingent liability – that is the cost of natural disaster claims against the EQC; the larger the fund, the smaller the chance that the

Crown guarantee will be called on. A secondary issue is the appropriate mix of investments for the NDF. Both issues will need to be reassessed in the light of the Canterbury earthquake, which is likely to result in payments from the NDF of up to \$1.5 billion (with EQC's reinsurance covering any costs above this).

Government priorities

The short- to medium-term priorities include managing claims associated with the Canterbury earthquake and continuing to ensure that all of the Commission's assets are appropriate and aligned with its role of providing natural disaster cover.

Government Superannuation Fund



\$10 billion unfunded liability

Around **68,000** members

Entitlements will continue for the next **60 years**

- Recognises the obligation to pay historical public sector defined benefit pension scheme, and manages assets to fund that obligation
- Investment performance below benchmark, and liabilities significantly higher than assets
- No plans to become fully funded

Description

The Government Superannuation Fund Authority is an autonomous Crown entity, which manages and administers the Government Superannuation Fund (GSF) and the GSF Schemes.

GSF was established in 1948 and membership was closed to all persons in 1995.

There are currently approximately 68,000 members, made up of some 15,000 contributors, 6,000 deferred pensions and 47,000 annuitants. Since 1996, the number of annuitants has exceeded the number of contributors and will continue to do so. It is expected that entitlements will continue to be paid by GSF for the next 60 years or so.

Composition and performance

Prior to 2001 GSF was invested entirely in New Zealand fixed interest securities. Since then it has diversified into growth assets like property and shares, which now comprise approximately 75% of the Fund.

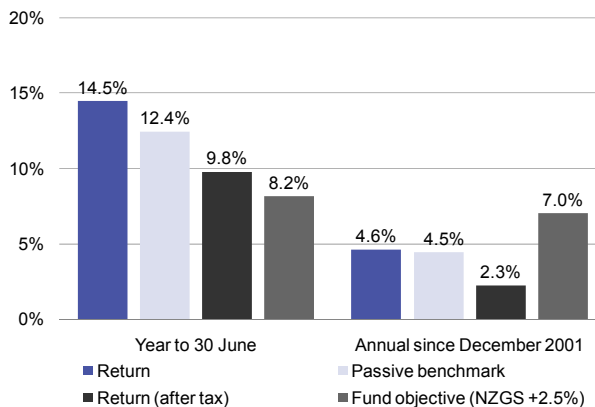
GSF's assets are insufficient to cover its projected liabilities (ie, its commitments to pay future entitlements). This shortfall was caused primarily by successive governments deciding not to make employer contributions to the Fund during the term of contributors' government service. As a result the investment returns on the smaller asset base of the Fund, combined with contributions from members and non-government employers, are not sufficient to meet the annual cost of entitlements to members. The Government Actuary determines on an annual basis the share of benefits payable by the Fund and the Crown.

The Fund is managed on an active basis, meaning fund managers are employed to outperform relevant market benchmarks, such as the NZ Equity Market Index. The Fund’s investment objective is to (after-tax) outperform the New Zealand Government Stock Index return (after-tax) plus at least 2.5% per annum over rolling 10-year periods.

Risks and challenges

It is normal practice for a superannuation fund to match, as best as possible, its assets and liabilities. This ensures that any changes in the value of liabilities are also reflected in the value of assets resulting in an unchanged net position. It is not possible to achieve a match in the case where the assets are significantly lower than the liabilities, as in GSF’s case. Therefore the strategy of investing in growth assets is intended to reduce the unfunded liability as these assets are expected to grow at a faster rate than the value of the liabilities. This mismatch will provide volatility in the value of the unfunded liabilities over short periods of time.

Figure 23 – GSF returns

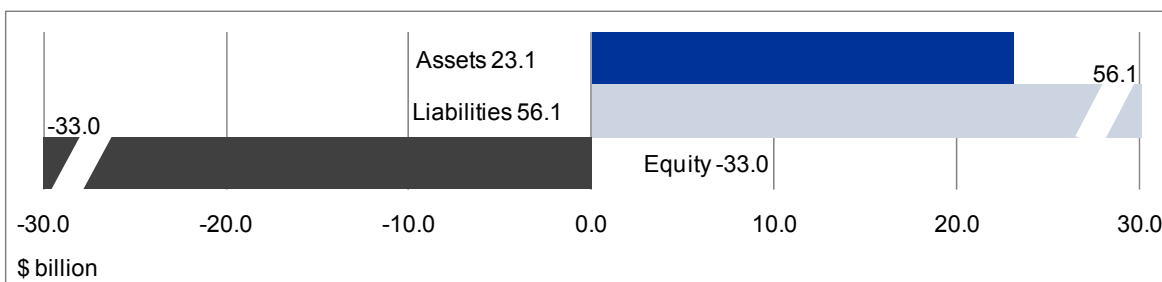


Source: The Treasury

Government priorities

The priority is to ensure the continued efficient management of GSF.

New Zealand Debt Management Office²⁶



Crown Debt Manager

6% long-term average cost of borrowing

Issuing around **\$240 million** of Government bonds each week

- Manages the Crown's debt
- Cost of borrowing currently lower than long-term average
- Higher borrowing requirements looking ahead

Description

NZDMO is responsible for funding the Government's borrowing requirements, and associated activities that include managing the Government's overall net cash flows and some of its interest-bearing assets.

Composition and performance

Composition: Financial liabilities

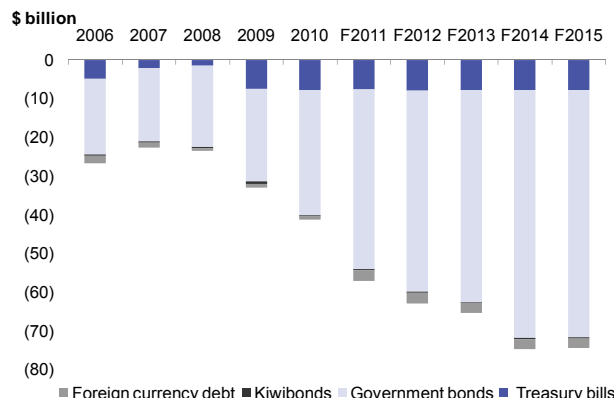
NZDMO's debt portfolio consists primarily of the New Zealand dollar (NZD)-denominated bonds and bills. These are currently issued by weekly tender. The portfolio includes a small amount of historical debt issued in foreign currency. NZDMO policy is to hedge foreign currency risk. From 2009, as the global financial crisis and associated recession flowed through to Crown revenue and expenditure, the Government's borrowing programme has increased. This increase is being met through increases in bond and bill issuance. Figure 24 shows total outstanding debt issued by NZDMO as at each year-end since 2006.²⁷

²⁶ NZDMO is an operating unit of the Treasury, and has no separate legal identity. Formal financial reporting is consolidated into the Crown financial statements. The figures in this section are taken from the pro-forma balance sheet information that is included as a Schedule to the Treasury's *Annual Report*; they differ from the figures on p. 52 due to eliminations (see footnote 14).

²⁷ The figure excludes debt issued to EQC and RBNZ, which stood at \$7.2 billion as at 30 June 2010.

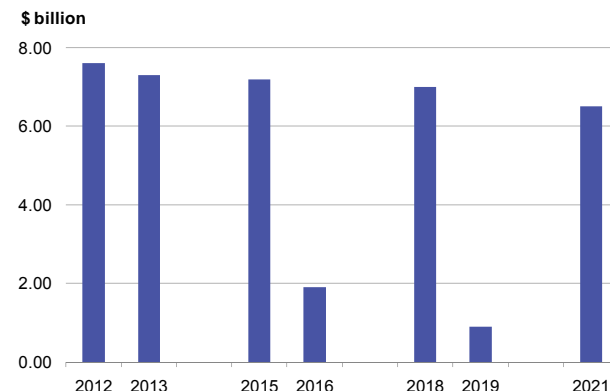
Debt issued by NZDMO

Figure 24 – Debt outstanding (actual and forecast)



Source: The Treasury

Figure 25 – Maturity profile of the NZD bond portfolio



Source: The Treasury

Composition: Cash and financial assets

Assets managed by NZDMO include cash, marketable securities, a derivatives portfolio, the Crown’s International Monetary Fund (IMF) financial assets and advances to Crown agencies.²⁸ Figure 26 shows the growth in cash²⁹ and marketable securities managed by NZDMO between 2006 and 2010. These assets provide a buffer when the Government’s cash requirements increase suddenly, as they may be used to smooth the increase in the borrowing programme. NZDMO policy is to invest in financial assets with high credit quality and for terms typically extending to five years.

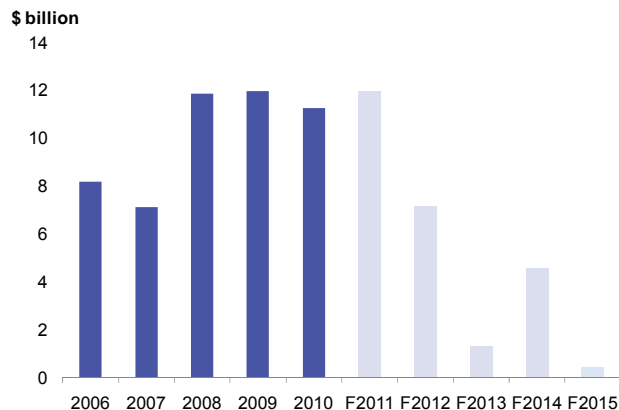
Cash and marketable securities managed by NZDMO

Movement in the level of cash and marketable securities over the forecast period is owing to the funding requirements associated with repaying maturing bonds in 2013 and 2015.

Performance

NZDMO’s goal is to manage debt and assets in a way that minimises costs while keeping risk at an appropriate level. A key measure of NZDMO success is the New Zealand Government’s cost of borrowing. For the year ending 30 June 2010, the cost of new borrowing averaged 4.2%, relative to the long-term average of 6% (NZDMO acknowledges that there are many factors influencing borrowing costs that are outside its control).

Figure 26 – Cash and marketable securities managed by NZDMO



Source: The Treasury

²⁸ At 30 June 2010, Crown advances to Crown agencies managed by NZDMO stood at \$2.7 billion to the RBNZ, \$1.5 billion to the Crown Health Financing Agency, \$1.8 billion to HNZC and \$0.4 billion to KiwiRail.

²⁹ Cash figures exclude collateral held by NZDMO.

NZDMO also reports against a range of more detailed indicators. A summary of NZDMO's 2009/10 performance is set out below. Performance targets were met for all dimensions. For more detailed information refer to the Treasury's *Annual Report*.

| Performance dimension | Target | Summary of performance in 2009/10 |
|---|---|---|
| Compliance with risk management policies for portfolio management and debt issuance | No more than four breaches | There were four breaches in 2009/10: three liquidity policy breaches and one credit breach. |
| Value-added from management of the Crown's debt and related financial assets | \$40 to \$60 million | Value-added was \$69 million in 2009/10. |
| Average Value at Risk (VaR) for the investment and derivatives portfolios | Average monthly VaR is less than \$1.4 million | Average monthly VaR was \$0.8 million, at a confidence level of 95%. |
| Losses incurred from the credit-related sale of securities, or from default by a counterparty | No losses | No losses in 2009/10. |
| Number of settlement errors | No more than 12 errors; losses do not exceed \$10,000 | There were four settlement errors, at a cost of \$1,689 to the Crown. |

Risks and challenges

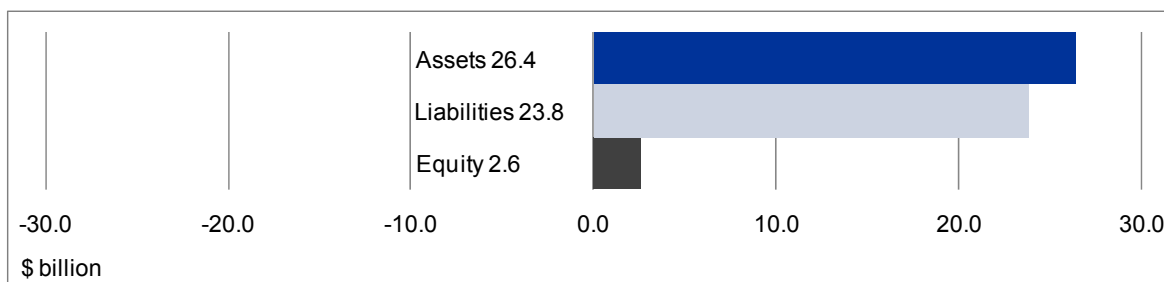
NZDMO has adopted formal policies to manage the market, credit, liquidity, funding and operational risks in its financial portfolio. A key risk in the current environment is that borrowing costs may rise owing to large increases in global sovereign-debt issuance (which could reduce international investor demand), and/or a perceived increase in New Zealand's sovereign risk.

Government priorities

The priority for NZDMO is to ensure that it can continue to fund the Government's borrowing requirements at a reasonable cost. To this end, NZDMO will focus on:

- managing the structure of the debt portfolio
- maintaining an effective marketing programme to retain existing investors and encourage new investors
- initiatives to promote liquidity in the domestic bond market, and
- ongoing improvements in operating efficiency and risk management policies.

Reserve Bank of New Zealand



\$11.3 billion foreign reserves
intervention capacity, including
\$2.9 billion unhedged
\$3.9 billion currency in circulation
\$13.9 billion deposits

- Provides financial system liquidity and crisis intervention capacity
- Experiencing increased volatility and exposure to external events
- Reviewing domestic liquidity facilities and composition of foreign reserves

Description

RBNZ is the nation's central bank and has three main functions: monetary policy; financial stability; and issuing currency. The Bank's balance sheet holds substantial assets and liabilities, mainly related to its financial stability and currency functions. Some of these relate to day-to-day operations, while some relate to the capacity to intervene in a crisis.

The main components on the Bank's balance sheet are:

- *Foreign reserves intervention capacity* (\$11.3 billion asset) – These reserves provide the ability to quickly sell foreign currency and buy New Zealand dollars, should market conditions warrant such an action. The majority of these reserves are hedged (ie, movements in the exchange rate do not have an impact on the level). A portion – \$2.9 billion – is unhedged and would allow the Bank to sell foreign currency outright without having to later purchase or borrow foreign currency.
- *Deposits* (\$13.9 billion liability) – The Bank operates as a “banker to the banks”: financial institutions and the Government hold deposits with RBNZ. These deposits are a liability to the Bank, because they could be called on by the institutions who hold them.
- *Currency in circulation* (\$3.9 billion liability) – The Bank issues notes and coins into circulation. Currency is a liability to the Bank, because the currency can be redeemed by the holders (generally trading banks).

Together these three components represent 43% of assets and 75% of liabilities.

Composition and performance

The composition of the Bank's balance sheet has changed significantly over the past 15 years. Assets have increased from \$7.6 billion in 1995 to \$26.4 billion in 2010. The main drivers in this increase have been:

- an increase in the Crown's Settlement Account, reflecting NZDMO's greater pre-funding of expected cash requirements

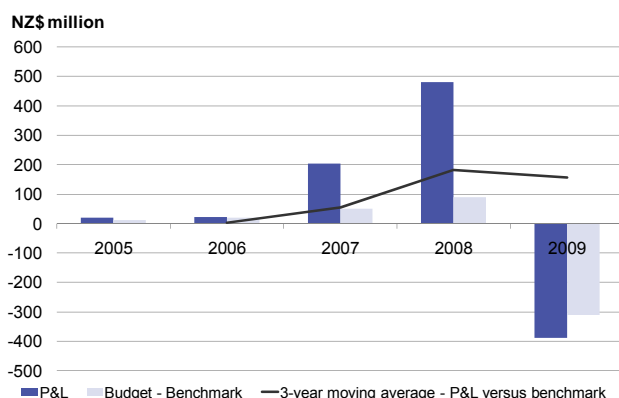
- an increase in foreign reserves, reflecting a policy decision in 2004 to provide additional capacity to intervene in the foreign exchange market to help maintain its functioning in a crisis situation
- an increase in new liquidity management provisions, reflecting a policy change in 2006 requiring intra-day payments by banks to be fully “cashed up” (prior to 2006, banks were able to borrow from RBNZ intra-day to cover these payments), and
- increased currency in circulation, reflecting growth in economy and associated transactions.

During 2009, the Bank’s balance sheet increased further owing to increased lending to domestic banks and financial institutions as support during the global financial crisis (part of which was funded through resuming the issuance of Reserve Bank bills). These loans have largely matured over the last year and no longer appear on the Bank’s balance sheet.

The Bank reports against a range of indicators relating to its three main functions outlined above, including, for example, consumer price index (CPI) inflation and counterfeits per million notes in circulation. Key indicators of financial performance for the 2009/10 year include:

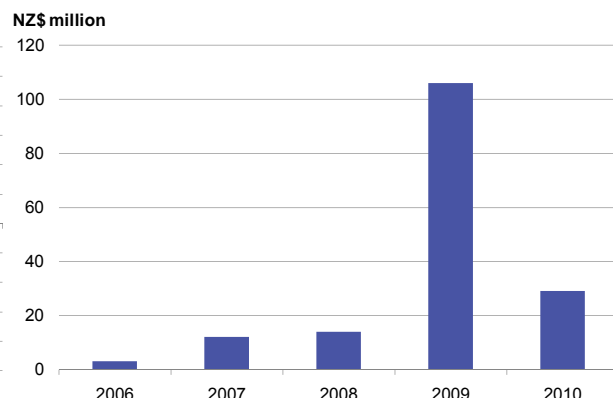
- Payment of a dividend to Government of \$290 million for the 2010 year. This dividend is in addition to a voluntary dividend payment in April 2010 of \$45 million.
- A loss of \$111 million for the year ended 30 June 2010. This is largely owing to losses on the revaluation of the Bank’s unhedged foreign exchange reserves and revaluation of the Bank’s long-term foreign currency funding owing to changes in interest rates. Increased volatility in financial outcomes is a likely consequence of the changes in the composition of the Bank’s balance sheet noted above.

Figure 27 – Return on foreign reserves management (including open FX position)



Source: RBNZ

Figure 28 – Total domestic markets net income



Source: RBNZ

Risks and challenges

The key risks to and challenges for RBNZ's balance sheet include:

- material movements in foreign exchange markets and the value of the New Zealand dollar
- the potential for further support for the domestic banking sector, and
- managing the Crown Settlement Account given the significant increase in borrowings to pre-fund future deficits.

Government priorities

Strategic priorities for RBNZ in relation to its balance sheet include:

- reviewing and adjusting the provision of temporary back-up liquidity facilities and collateral that may be required under various market scenarios
- reviewing the foreign reserves portfolio to ensure the investment strategy aligns with the foreign exchange intervention strategy, and
- developing its systems and processes to better develop the benchmarks for the Bank's foreign reserves which will provide a better basis for assessing actual outcomes and performance against the related formal benchmark.

High-level choices in the financial portfolio

Any government faces choices in relation to what financial assets it will invest in, what debt and other liabilities it will take on or reduce and how financial risks will be managed. There is also a range of choices for managing and matching the performance of financial assets to their underlying liabilities and, over and above this matching, for what level of additional risk, if any, the Crown is willing to take on in order to meet its objectives.

Currently the responsibility for managing financial assets is devolved to individual Crown agencies and will depend on:

Policy settings: Policy decisions impact on what the Crown owns and owes. For example, ACC liabilities depend on the entitlements under the ACC scheme which can be changed.

Funding levels: Choices exist over which expenses are funded in advance and the level to which they are funded. The Government's current policy is to move towards having EQC and ACC (except for residual claims relating to the Non-Earners' Account) fully funded and future New Zealand Superannuation payments partially pre-funded. There is also a choice as to how fast these funds build up (eg, ACC levies could be raised to allow for a faster build-up of financial assets, moving towards full funding sooner).

Investment parameters: Parameters can be set as to what type of assets the Crown invests in, such as the mixture of debt and equity instrument holdings, whether to maintain a certain level of investment in New Zealand companies and whether to invest only in listed companies or to take an equity share in privately owned companies (eg, NZSF's recent purchase of 50% of Shell's New Zealand assets). These decisions will depend on the Crown's underlying risk tolerance and will in turn impact the risk profile and returns generated by these assets.

Portfolio management: The organisations holding these assets can either actively or passively manage their portfolios and either manage their portfolios in-house or outsource them. The approach to portfolio management currently varies between CFIs. The way in which the portfolios are managed will impact the level of returns achieved and the level of fees paid to fund managers.

Institutional arrangements: At present the five CFIs are separate entities. A single fund manager across CFIs might increase efficiency and overall performance, and enable better aggregate risk management across the financial portfolio. The institutional arrangements for governments' borrowing activities vary globally. Many countries have adopted a similar approach to NZDMO or a variation of it.

Commercial assets and liabilities³⁰

Introduction

Purpose

The commercial assets and liabilities on the Crown's balance sheet consist of the 17 SOEs and Air New Zealand.³¹ The portfolio is therefore comprised largely of entities operating in openly competitive environments where they compete with private sector entities in the supply of goods and services. A minority occupy certain niche/monopoly positions in the economy and are not subject to competition. In these cases if there are price or access issues they are subject to regulatory control. Regardless, they are all companies with principally commercial objectives.

Broadly speaking any increase in the value of the portfolio contributes to overall Crown net worth and therefore, indirectly, to reducing the costs of capital faced in the economy. In addition, any dividends received can be used to fund public services, the costs of which might otherwise be met from taxation or from borrowing.

These considerations need to be balanced against the costs – including opportunity costs – of ongoing Crown ownership.

More detailed information on the commercial portfolio can be found in the COMU APR 2010.

Current holdings

The current SOE portfolio consists of 17 companies with a combined commercial value of just over \$18 billion.³² In addition to the 17 SOEs, the Crown also has around a 76% shareholding in Air New Zealand, a company listed on the NZX. The Crown's shareholding has a current valuation of around \$880 million.

The composition of the portfolio reflects the residual result of broader policy choices rather than a deliberate choice to meet specified commercial investment goals – such as maximising return and/or reducing risk – as would normally be the case for a portfolio of investments. A detailed breakdown of the commercial portfolio (apart from the two non-operational SOEs) is provided in the following table.

³⁰ For the purposes of the Government's financial statements any transactions between entities within the Crown reporting group are eliminated. However, the entity-specific reporting in this section includes transactions made to entities within the Crown reporting group, so reported numbers will differ.

³¹ The Government's financial statements identify any assets, liabilities, income and expenses attributable to minority interests in Air New Zealand.

³² This includes two non-operational SOEs consisting only of some residual assets, Timberlands West Coast and Electricity Corporation of New Zealand (ECNZ).

| Company | Assets \$m | Liabilities \$m | Equity \$m | Valuation \$m | Total shareholder return (5-year average) | Description of activities |
|---|---------------|--------------------|---------------|------------------|---|--|
| Air New Zealand Ltd | 4,597 | 3,031 | 1,566 | 1,159.8 | 19% | Air passenger and cargo transport services |
| Airways Corporation of New Zealand Ltd | 143.1 | 97.6 | 45.6 | 113 | 13.1% | Air navigation services |
| Animal Control Products Ltd | 6.7 | 1.5 | 5.2 | 6.5 | 28.6% | Manufacture and sale of pest management products |
| AsureQuality Ltd | 57 | 25.9 | 31.1 | 85.4 | n/a ³³ | Inspection, auditing, testing, training and biosecurity surveillance and response services |
| Genesis Power Ltd | 2,532.3 | 1,086.8 | 1,445.6 | 1,624 | 5.5% | Electricity generation and retailing |
| Kordia Group Ltd | 257.1 | 161.1 | 96 | 198.5 | 28% | Telecommunications engineering services |
| Landcorp Farming Ltd | 1,521.9 | 284.8 | 1,237.2 | 1,270 | 12.8% | Pastoral farming and land development |
| Learning Media Ltd | 12.7 | 7.2 | 5.5 | 10.5 | 27.9% ³⁴ | Publication, marketing and sale of educational materials |
| Meridian Energy Ltd | 8,715.6 | 3,644.9 | 5,070.7 | 6,700 | 14.9% | Electricity generation and retailing |
| Meteorological Service of New Zealand Ltd | 29.2 | 16.5 | 12.7 | 43.9 | 5.6% | Weather forecasts and related information presentation services |
| Mighty River Power Ltd | 4,894.9 | 2,205.9 | 2,689 | 3,425 | 42.9% | Electricity generation and retailing |
| New Zealand Post Ltd | 13,075.5 | 12,242.9 | 832.5 | 1,374 | 34% | Banking, postal and courier services |

³³ AsureQuality was formed in October 2007. Figures are for 2008/09.

³⁴ Four-year average as no commercial valuation was undertaken in 2004/05.

| Company | Assets \$m | Liabilities \$m | Equity \$m | Valuation \$m | Total shareholder return (5-year average) | Description of activities |
|-------------------------------------|---------------|--------------------|---------------|-------------------|---|--|
| New Zealand Railways Corporation | 13,248.8 | 829.4 | 12,419.4 | n/a ³⁵ | n/a | Rail and infrastructure provision |
| Quotable Value Ltd | 32.8 | 10.7 | 22.1 | 34.4 | 17.2% | Property valuation |
| Solid Energy New Zealand Ltd | 1,000.2 | 556.8 | 443.4 | 3,275.6 | 115.1% | Development, production and marketing of coal and associated energy products |
| Transpower New Zealand Ltd | 3,565.5 | 2,110.5 | 1,455 | 1,600 | 7.7% | Electricity transmission |

Source: 2010 Company Annual Reports and Statements of Corporate Intent

The SOE portfolio is dominated by energy sector assets, comprising three electricity generator/retailers, a coal mining company and an electricity transmission company. Eighty-four percent of the total equity (excluding KiwiRail and Air New Zealand) is in these five companies. In addition, the portfolio includes a number of very small companies, some in wind-down or liquidation mode.

A significant proportion of the liabilities within the commercial portfolio represent external private sector debt obtained by SOEs on terms and conditions that reflect the stand-alone nature of the company. The Crown guarantees neither the operations nor the funding of SOEs.

Summary performance measures

To build a consistent picture around SOE performance, SOEs have been asked to report on a standard range of measures. These measures and more detailed information on the performance of the commercial portfolio³⁶ can be found in the COMU APR 2010.

Briefly, the principal objective of every SOE, as laid out in legislation, is to operate as a successful business and, to this end, be as profitable and efficient as comparable businesses that are not owned by the Crown. They are also required to exhibit a sense of social responsibility and be good employers as part of their principal objective to be successful businesses.

Accordingly, in relation to operational performance, the expectation is that SOEs can at least match peers' performance on the same basis. In addition, as a judicious investor in

³⁵ New Zealand Railways Corporation trades as KiwiRail. KiwiRail's track assets are currently valued on a replacement cost basis (optimised depreciated replacement cost, ODRC) rather than on a commercial basis. ODRC valuations are standard for non-market public assets such as hospitals but the ODRC value does not give a good indication of the commercial valuation of KiwiRail.

³⁶ The COMU APR uses a different definition of "commercial portfolio". The category used in the APR consists of all operational SOEs excluding New Zealand Railways Corporation and New Zealand Post, but including the non-SOEs TVNZ, Public Trust and Air New Zealand.

a commercial portfolio facing competing demands on its investment capital, the Crown will be looking for overall returns greater than its cost of borrowing plus an appropriate risk premium. The average 10-year bond rate was 6%. Therefore the Crown should have a reasonable expectation of returns comfortably exceeding this amount.

The COMU APR summarises the overall performance of the commercial portfolio. The report concludes that:

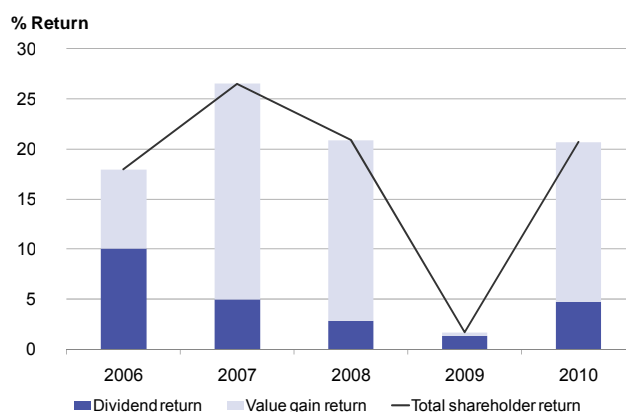
- the companies have invested heavily in new plant and other assets, mostly in New Zealand
- this investment has been funded from internally-generated cash flow and a modest increase in borrowing
- gearing has increased but is still well within reasonable bounds
- revenue and earnings have been relatively static
- dividend payments are volatile from year to year, with little discernible trend, and
- the average level of dividend payments remains low relative to comparable companies.³⁷

In other words, there has been a recent period of high investment by SOEs but the Crown, as owner of these assets, has yet to see returns commensurate with the value of its investments. In addition, the volatility of dividend payments makes it more difficult than it could be for the Crown to plan and finance its public-good expenditure.

Ensuring that recent and historic investments in the commercial portfolio generate appropriate returns for their owners will be a key focus in a capital constrained environment.

Shareholder return comes from the combination of dividends paid and the change in commercial value of the company. Figure 29 illustrates total shareholder returns for the COMU commercial portfolio. The volatility is largely caused by companies moving from historic cost book value to commercial valuation methods at different times.

Figure 29 – Total shareholder returns



Source: COMU APR

³⁷ See COMU APR.

High-level choices in the commercial portfolio

In managing the commercial portfolio, Government has ownership responsibilities in relation to the governance and direction of the portfolio. As an owner the Crown will be interested in how it manages and achieves value from its commercial assets. This revolves around choices about what activities the commercial entities will carry out and why; and what business structures and delivery models they utilise.

This suggests that the strategic issues relating to the commercial portfolio are:

Portfolio size: The Crown currently owns around \$53 billion of assets in commercial companies, just under a quarter of the entire value of assets on the Crown's balance sheet. Ensuring the performance and composition of the portfolio aligns with the Crown's overall balance sheet objectives is therefore crucial and will depend on:

- the nature of any expansion in the companies' operations domestically or globally
- the nature of the capital used to fund any expansion; for instance, Crown capital, deferred dividends or external debt funding
- any changes in ownership through new investment or divestment (in part or in full), and
- how the resulting characteristics and risk profile of the portfolio are managed, monitored and match the Crown's own capabilities and expertise.

Asset mix: The Crown's commercial portfolio in terms of equity value (rather than accounting value) is dominated by electricity generation assets, a coal mining company and an electricity transmission company and therefore is strongly weighted towards the energy sector. The mix of assets will determine the level of returns it can generate and the risks involved in generating those returns.

Organisational arrangements: The Crown can alter the organisational arrangements over these assets to meet different objectives. The SOEs are currently set up as companies with individual boards and are instructed to operate on a commercial basis under the State-Owned Enterprises Act 1986. Changes to the organisational structure and form, the allocation of control rights and stated functions and objectives could all impact on the way in which these companies operate, with an impact on returns.

Investment/ownership objectives: As suggested above, the portfolio has not been put together with specific commercial investment goals in mind. The composition of the portfolio, and the scope of activity, is a consequence of a mix of active retention of assets, some repurchases and those commercial assets remaining in Crown ownership following asset rationalisation programmes in the 1980s and 1990s.

Placing a greater weighting on commercial investment objectives may involve an increased emphasis on the portfolio's ability to generate cash from business operations, generate appropriate levels of dividend to the Crown, add value in a way commensurate with broader ownership objectives, or some combination of the above.

Provisions and contingencies

| | |
|---|---------------|
| <i>Provisions (liability):</i> | \$6.0 billion |
| <i>Quantified contingent assets:</i> | \$0.6 billion |
| <i>Quantified contingent liabilities:</i> | \$6.4 billion |
| <i>Unquantified contingent assets and liabilities:</i> Disclosed in notes to the financial statements | |

Description

Provisions are liabilities of uncertain timing or amount. As liabilities, provisions are recorded in the balance sheet. The recorded liability is estimated based on the amount of liability which is *probable*.

Contingent assets and liabilities are not recorded on the balance sheet but must be disclosed separately in the financial statements. They represent:

- a *possible* binding obligation dependent on uncertain future events, or
- a present obligation which cannot be measured with reliability for inclusion on the balance sheet.

Composition – provisions

Provisions over time are shown in Figure 30. It shows:

- The largest provision is for employee entitlements such as annual and sick leave to which existing public sector employees are entitled.³⁸
- The guarantee of NPF's pension liability is the next largest item.
- New Zealand's emissions profile and carbon pricing impacts on the Government position under the Kyoto protocol. A provision for a net liability existed over 2005 to 2008, but reversed to an asset position following revised estimates.
- The most significant recent development in terms of provisioning has been the advent of retail deposit guarantee schemes. On 12 October 2010, the original scheme put in place during the global financial crisis expired. It was replaced with a new one which has tighter eligibility criteria and pricing which better reflects the risk profile of guaranteed financial institutions, expiring on 31 December 2011.

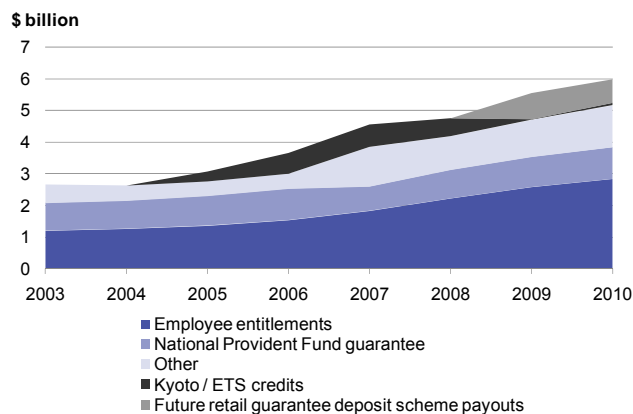
As at 30 June 2010, 73 financial institutions had joined the former scheme with guarantees on deposits totalling \$133 billion. This was the Crown's maximum contingent liability and did not include any offset resulting from the recovery of the remaining assets of the financial institution in the event the guarantee is called upon. The provisions for the estimated net losses (after recoveries) for those entities considered more likely than not to default was \$748 million as at 30 June 2010. After 30 June 2010, three entities covered by the Crown guarantee (including South Canterbury Finance) defaulted, triggering the

³⁸ Note that obligations under GSF are accounted for separately.

Crown’s obligation under the guarantee. The Treasury currently expects that the provisions will be adequate to cover the final net cost under the guarantee scheme.

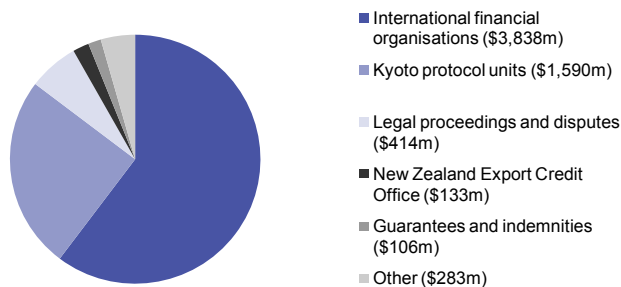
As at 31 October 2010, the Crown determined that no provision was required in relation to its contingent liability under the extended guarantee scheme.

Figure 30 – Provisions, 2003 to 2010



Source: The Treasury

Figure 31 – Quantifiable contingent liabilities, 30 June 2010



Source: The Treasury

Composition – contingencies

Figure 31 shows the quantified contingent liabilities as at 30 June 2010 which total \$6.4 billion (excluding the wholesale and retail deposit guarantee schemes). The largest is for international financial organisations such as the Asian Development Bank, which is mostly uncalled capital relating to New Zealand’s membership. A contingent liability relating to the Kyoto protocol for forestry units depends on the extent of harvesting and the nature of future international negotiations. The New Zealand Export Credit Office is a commercially-oriented entity which provides guarantees to exporters for trade credit or insurance.

Quantified contingent assets are comparatively small at \$572 million as at 30 June 2010, mostly relating to legal proceedings and disputes.

Risk management

Provisions and contingencies are managed across the State sector, with financial oversight from the Treasury and regular disclosure through monthly and annual financial statements. There are strict processes around entities developing new exposures. For example, the Public Finance Act 1989 states that government departments may only give guarantees and indemnities as specified in regulations and if it is in the public interest to do so.

Departments and Crown entities manage employee entitlements and smaller ordinary provisions on their own balance sheets. The Minister of Finance and the Treasury tend to administer items which relate to the Crown as a whole rather than a particular department or Crown entity, such as the Retail Deposit Guarantee Scheme, obligations relating to the international financial organisations and the New Zealand Export Credit Office.

Contingent obligations to international financial organisations are judged to be justified by the membership benefits for New Zealand. Contingent capital may be called if an injection

of funds is needed by these institutions (for example, to support balance of payments of other countries). This would create an asset for the Crown, mitigating the risk of loss to the Crown.

A range of upside and downside risks can affect the overall fiscal position, and consequently the Government's balance sheet if they eventuate. Balance sheet risks are discussed in Section 4 and in the information on fiscal risk in the HYEPU 2010.

What's not on the balance sheet?

The GAAP balance sheet represents the Crown's assets and debt and other obligations which are binding, according to accounting recognition criteria. Contingent assets and liabilities must be disclosed separately on the balance sheet. However, a more comprehensive view of the Crown's financial position would require consideration of all the Crown's resources and social obligations – some of which may not meet accounting recognition criteria. Most importantly, this includes the power to tax and the implicit obligation to provide public services and transfers. The main means of providing this information is through the Government's *Fiscal Strategy Report*, half-yearly *Economic and Fiscal Updates* and the Treasury's *Long-term Fiscal Statement*.

An example of an obligation of future expenditure that is recorded on the GAAP balance sheet is the ACC liability, which is for accidental injuries that have already occurred. Much other future social expenditure, including New Zealand Superannuation and welfare benefits, is not on the GAAP balance sheet because these are policy commitments only and not contractually binding on the Crown.

New Zealand Superannuation

New Zealand Superannuation is a universal entitlement to a retirement income for New Zealand residents 65 years of age and older. Future liability can be anticipated using population projections and an assumption of constant policy settings.

Challenges and Choices: New Zealand's Long-term Fiscal Statement (The Treasury, 2009) shows that the number of New Zealand Superannuation recipients is expected to rise from 522,000 in 2009 to 1.3 million in 2050. Based on the projections of GDP at the time, this would nearly double the cost of New Zealand Superannuation as a share of national income over the next 40 years from 4.3% of GDP to 8% in 2050. All other things being equal, this type of expenditure pressure will translate into declining balance sheet equity if left unmanaged. Regardless of whether GAAP recognition criteria are met, this type of foreseeable pressure should influence management of the balance sheet into the medium and longer term.

Welfare benefits

One way to look at working-age welfare benefits is to consider them in a similar way to ACC's balance sheet liability: the estimated future obligation to those currently on a benefit, discounted to today's dollars. The Welfare Working Group recently calculated the average lifetime cost of those currently on a benefit, and then multiplied the results by total current recipients to provide an estimated total future liability. And the results are interesting: the present value cost of existing beneficiaries totals \$45 billion – significantly more than ACC's gross liability of \$27 billion.

Future welfare benefit liability estimates (real 2009 dollars)

| Benefit type | Average lifetime cost per person (\$) | Total cost (\$billion) |
|---------------------------|--|---------------------------|
| Invalid's benefit | 192,000 | 16.7 |
| Sickness benefit | 140,000 | 8.1 |
| Unemployment benefit | 65,000 | 3.6 |
| Domestic Purposes benefit | 161,000 | 17.1 |
| Total | | 45.5 |

(Ministry of Social Development [2010]. *Future Liability: Estimating time on benefit and the associated cost*, Centre for Social Research and Evaluation, Ministry of Social Development, Wellington, New Zealand, p.6)

Putting commitments in terms of their present value can help to inform policy making. The New Zealand Government first produced GAAP financial statements in the early 1990s. Among other things, this showed that there was a large unfunded liability associated with the defined-benefit pension scheme for public-sector employees. This disclosure enabled the government of the day to recognise there was a problem and make changes – the scheme was closed to new members. Today, many other governments around the world are grappling with the looming cost of equivalent defined-benefit schemes.

The Forecast Balance Sheet

The following table shows the forecast movement in the balance sheet over the next five years. The forecast asset values in the table below do not include revaluations of physical assets.

Forecast Statement of Financial Position

as at 30 June

| | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | Change between 2010 and 2015 | |
|---|----------------|----------------|----------------|----------------|----------------|----------------|---------------------------------|--------------|
| | Actual | Forecast | Forecast | Forecast | Forecast | Forecast | | |
| | \$m | \$m | \$m | \$m | \$m | \$m | \$m | % |
| Assets | | | | | | | | |
| Cash and cash equivalents | 7,774 | 9,687 | 9,624 | 9,597 | 9,938 | 10,201 | 2,427 | 31.2 |
| Receivables | 13,884 | 14,970 | 14,026 | 13,563 | 13,530 | 13,886 | 2 | 0.0 |
| Marketable securities, deposits and derivatives in gain | 43,687 | 42,375 | 38,641 | 34,382 | 38,970 | 35,504 | (8,183) | -18.7 |
| Share investments | 12,179 | 13,704 | 16,945 | 19,627 | 22,379 | 25,346 | 13,167 | 108.1 |
| Advances | 18,447 | 19,642 | 23,354 | 24,181 | 24,407 | 24,600 | 6,153 | 33.4 |
| Inventory | 1,160 | 1,245 | 1,293 | 1,338 | 1,369 | 1,421 | 261 | 22.5 |
| Other assets | 1,661 | 1,705 | 1,703 | 1,709 | 1,705 | 1,703 | 42 | 2.5 |
| Property, plant & equipment | | | | | | | | 0.0 |
| Land | 16,688 | 16,895 | 16,934 | 16,966 | 17,097 | 17,238 | 550 | 3.3 |
| Buildings | 24,019 | 24,921 | 25,437 | 25,568 | 25,767 | 25,595 | 1,576 | 6.6 |
| Electricity distribution network | 2,251 | 2,722 | 3,336 | 3,822 | 4,022 | 4,224 | 1,973 | 87.6 |
| Electricity generation assets | 13,642 | 13,830 | 13,818 | 14,372 | 14,818 | 15,247 | 1,605 | 11.8 |
| Aircraft | 1,731 | 1,842 | 2,365 | 2,648 | 3,071 | 3,204 | 1,473 | 85.1 |
| State highways | 24,838 | 26,033 | 26,795 | 27,548 | 28,407 | 29,374 | 4,536 | 18.3 |
| Rail network | 12,437 | 13,076 | 13,418 | 13,875 | 14,283 | 14,505 | 2,068 | 16.6 |
| Specialist military equipment | 3,413 | 3,494 | 3,526 | 3,391 | 3,179 | 2,965 | (448) | -13.1 |
| Specified cultural and heritage | 8,505 | 8,480 | 8,526 | 8,555 | 8,579 | 8,604 | 99 | 1.2 |
| Other plant and equipment | 5,806 | 6,035 | 6,336 | 6,395 | 6,642 | 6,793 | 987 | 17.0 |
| Equity accounted investments | 9,049 | 9,345 | 9,554 | 9,773 | 9,976 | 10,173 | 1,124 | 12.4 |
| Intangible assets and goodwill | 2,184 | 2,369 | 2,464 | 2,429 | 2,371 | 2,308 | 124 | 5.7 |
| Forecast for new capital spending | - | 292 | 1,024 | 1,731 | 2,712 | 3,882 | 3,882 | |
| Top-down capital adjustment | - | (350) | (500) | (500) | (500) | (500) | (500) | |
| Total assets | 223,355 | 232,312 | 238,619 | 240,970 | 252,722 | 256,273 | 32,918 | 14.7 |
| Liabilities | | | | | | | | |
| Issued currency | 4,020 | 4,137 | 4,344 | 4,561 | 4,789 | 5,028 | 1,008 | 25.1 |
| Payables | 9,932 | 9,562 | 10,092 | 10,226 | 10,705 | 11,117 | 1,185 | 11.9 |
| Deferred revenue | 1,628 | 1,436 | 1,360 | 1,320 | 1,298 | 1,298 | (330) | -20.3 |
| Borrowings | 69,733 | 85,876 | 95,189 | 97,949 | 107,278 | 106,651 | 36,918 | 52.9 |
| Insurance liabilities | 27,131 | 29,604 | 30,464 | 32,001 | 33,685 | 35,557 | 8,426 | 31.1 |
| Retirement plan liabilities | 9,940 | 9,436 | 9,113 | 8,832 | 8,580 | 8,352 | (1,588) | -16.0 |
| Provisions | 5,983 | 6,452 | 6,353 | 6,620 | 6,003 | 5,146 | (837) | -14.0 |
| Total liabilities | 128,367 | 146,503 | 156,915 | 161,509 | 172,338 | 173,149 | 44,782 | 34.9 |
| Asset Breakdown by: | | | | | | | | |
| Social | 110,938 | 113,858 | 115,958 | 117,893 | 120,510 | 123,044 | 12,106 | 10.9 |
| Financial | 60,007 | 62,629 | 61,832 | 59,925 | 66,879 | 66,348 | 6,341 | 10.6 |
| Commerical | 52,410 | 55,825 | 60,829 | 63,152 | 65,333 | 66,881 | 14,471 | 27.6 |
| Total assets | 223,355 | 232,312 | 238,619 | 240,970 | 252,722 | 256,273 | 32,918 | 14.7 |
| Liability Breakdown by | | | | | | | | |
| Social | 13,938 | 14,708 | 14,892 | 14,999 | 14,487 | 13,654 | (284) | -2.0 |
| Financial | 92,455 | 107,807 | 113,617 | 116,662 | 126,782 | 127,566 | 35,111 | 38.0 |
| Commerical | 21,975 | 23,988 | 28,406 | 29,847 | 31,070 | 31,929 | 9,955 | 45.3 |
| Total liabilities | 128,367 | 146,503 | 156,915 | 161,509 | 172,338 | 173,149 | 44,782 | 34.9 |
| Total net worth | 94,988 | 85,809 | 81,704 | 79,461 | 80,384 | 83,124 | (11,864) | -12.5 |

Source: The Treasury

The table above shows that although assets are forecast to increase by \$32.9 billion from \$223 billion to \$256 billion over the period, liabilities are forecast to increase by \$44.8 billion, driven largely by an increase in borrowing and an increase in the ACC liability. This results in a \$12 billion decrease in net worth over the period.

How investment in property, plant and equipment is funded over the forecast period

| | 2010 Actual \$m | 2011 Forecast \$m | 2012 Forecast \$m | 2013 Forecast \$m | 2014 Forecast \$m | 2015 Forecast \$m |
|--|-----------------------|-------------------------|-------------------------|-------------------------|-------------------------|-------------------------|
| Crown funding of operations ¹ | 2,404 | 2,450 | 2,575 | 2,689 | 2,644 | 2,636 |
| Allocations from the capital allowance | 1,024 | 1,104 | 249 | 253 | 258 | - |
| Transport-related taxes ² | 860 | 948 | 820 | 759 | 784 | 973 |
| Other funding sources | 2,267 | 3,660 | 3,984 | 3,323 | 3,099 | 2,884 |
| Total additions | 6,555 | 8,162 | 7,628 | 7,024 | 6,785 | 6,493 |

1 These figures are a proxy based on the assumption that funding for purchasing PPE by departments and Crown entities equates to depreciation expenses.

2 These figures have been calculated by subtracting depreciation from total purchases of PPE.

Source: The Treasury

The table above identifies the sources of forecast funding for investment in PPE. These sources include existing agency funding from operational revenue, allocations from the annual capital allowance up to and including Budget 2010 (future allocations are *not* included, but some spending from earlier allocations is being phased over future years) and hypothecated taxes such as fuel excise. The figures provided are estimates of how actual capital expenditure will be funded and the anticipated timing of expenditure.

Forecast changes in asset values

| \$million | 2010 Actual | 2011 Forecast | 2012 Forecast | 2013 Forecast | 2014 Forecast | 2015 Forecast | 5-Year Total |
|---|----------------|------------------|------------------|------------------|------------------|------------------|-----------------|
| Addition of Property, plant and equipment | 6,555 | 8,162 | 7,628 | 7,024 | 6,785 | 6,493 | 36,092 |
| <i>Other large asset investments:</i> | | | | | | | |
| - Student loans issued | 1,525 | 1,547 | 1,558 | 1,580 | 1,602 | 1,622 | 7,909 |
| - NZS Fund reinvestment of returns | 1,968 | 1,403 | 1,236 | 1,340 | 1,456 | 1,583 | 7,018 |
| - ACC reinvestment of returns | 2,694 | 3,538 | 2,621 | 2,924 | 3,166 | 3,357 | 15,606 |
| - Forecast for new capital spending | - | 292 | 732 | 707 | 981 | 1,170 | 3,882 |
| Approximate gross change in assets | 12,742 | 14,942 | 13,775 | 13,575 | 13,990 | 14,225 | 70,507 |
| <i>Reduction in assets:</i> | | | | | | | |
| - Depreciation on PPE | (3,582) | (3,756) | (4,008) | (4,146) | (4,225) | (4,360) | (20,495) |
| - Reduction in NZDMO/RB financial assets | (2,846) | (176) | (5,675) | (6,367) | 3,273 | (5,385) | (14,330) |
| Other changes in assets | (110) | (2,053) | 2,215 | (711) | (1,286) | (929) | (2,764) |
| Net change in assets | 6,204 | 8,957 | 6,307 | 2,351 | 11,752 | 3,551 | 32,918 |
| Total assets | 223,355 | 232,312 | 238,619 | 240,970 | 252,722 | 256,273 | |

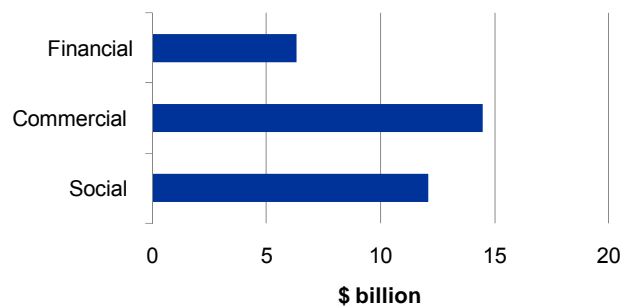
Source: The Treasury

The table above shows how different assets are forecast to increase owing to cash expenditure or reinvestment, and how total asset values will be reduced by, for example, depreciation on PPE and the reduction of financial assets.³⁹

³⁹ Annex 1 provides an alternative presentation of forecast changes in asset values, as well as changes in liabilities. It also provides more comprehensive forecast and historic balance sheet data.

The large “other changes in assets” movement in 2011 is a result of a reduction in EQC assets following on from the Canterbury earthquake, and the large upward movement in 2012 reflects Kiwibank forecast of deposits.

Figure 32 – Changes in assets over the forecast period (2010 to 2015)



Source: The Treasury

The table shows that:

- total investment over the next 5 years is large, at just over \$70 billion, and is about double the forecast increase in assets, at \$32.9 billion
- about half the total investment is in PPE (\$36.1 billion), and about a third of this investment is by SOEs and the other half by social agencies – largely in roads, schools and hospitals
- the other half of the total investment is largely in CFIs (NZSF and ACC), but also a sizeable increase in student loans (\$8 billion), and
- new capital invested by the Government each Budget is a relatively small proportion of the total investment, at \$4 billion.

As illustrated for the 2009/10 year in Section 1 of this *Investment Statement*, public capital expenditure supporting the growth in these assets is funded by different means:

- *Specific or hypothecated tax revenue* – Capital expenditure on roads is the largest category of spending. Capital expenditure on roads is funded from hypothecated tax revenue in the form of Petrol Excise Tax and Road User Charges. Other specific taxes include ACC levies.
- *New borrowing* – During periods where an operating deficit is being run, a large proportion of capital expenditure on social assets is funded by new borrowings. For example, the second largest category of capital spending after roads is education. Expenditure on the health sector and defence is also funded out of new borrowing.
- *KiwiRail* is the third largest area of spending on physical assets. KiwiRail is not expected to generate an operating surplus over the forecast period, therefore this capital expenditure will also be funded by core Crown borrowing.
- *SOE and Air NZ cash surpluses* – The three electricity generators/retailers are cash flow positive and will fund their forecast capital expenditure from their own surplus cash at the expense of dividends returned to the Crown. Transpower and Air NZ capital expenditure is also funded from their surplus cash.
- *Sale of existing assets* – A small proportion of expenditure is funded from the sale of existing assets. For example, housing capital expenditure is funded from a combination of the sale of existing state houses, HNZN operating surpluses and some funding received from the Crown (funded from new borrowings).

Social assets

Forecast through to 2015

The largest balance sheet grouping is the Crown's social assets and particularly the physical investment in roads and housing. The 2009 Budget brought forward planned spending on infrastructure and also introduced larger capital allowances for school property, housing and road projects.

Figure 33 shows how social assets are expected to move between 2010 and 2015.

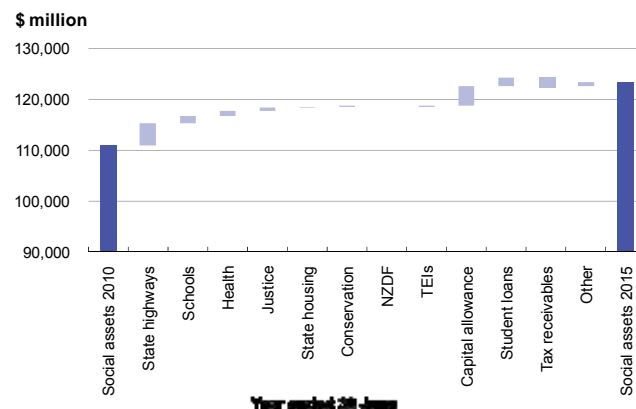
Social assets are expected to increase from \$111 billion to \$123 billion. The major contributions to this forecast increase are:

- An increase to PPE. Fifty-five percent of the increase in PPE is owing to a \$4.4 billion increase in the value of state highway roading over the period. Other contributing areas are a \$1.2 billion increase in the value of hospitals, and a \$520 million increase in the value of schools. These movements do not include revaluations.
- Student loans are expected to increase by \$1.7 billion over the five-year period after impairments and other changes (\$7.9 billion in new loans advanced will be initially written-down by \$3.6 billion, and offset by repayments of approximately \$5 billion).
- New spending. "Capital allowance" is the amount set aside in future Budgets for new capital expenditure that has yet to be allocated to specific organisations or assets.

These forecasts to 30 June 2015 take into account current levels of funding and *approved* forecast expenditure. Information is also collected from capital-intensive government agencies regarding their *capital intentions*, which includes details of what projects they intend to seek additional funding for in future years, as well as those they will advance within their current forecast funding levels. Capital intentions represent the asset-related spending scenario that individual agencies consider is most likely to apply given three things: the state of existing asset portfolios; a common set of economic, demographic and fiscal settings; and, importantly, continuation of current policy settings.

Agency intentions indicate that the new capital funding that will be sought for projects that are not yet approved is significantly higher than what will be available for allocation in future Budgets even within the forecast period. While it is unlikely that all signalled intentions will go on to be developed into business cases or go on to be funded, this highlights the need for careful prioritisation of new spending, alongside initiatives to manage demand levels better through changes to policy settings and service levels, improved utilisation of existing assets and delivering projects and services through cost-effective alternative procurement options.

Figure 33 – Forecast movements in social assets



Source: The Treasury

Projections into the longer term under current policy settings

Capital intentions for the 10-year period to 2019/20 signal expenditure intentions that are also higher than those that can be managed within current baselines and future allowances beyond the forecast period. This confirms that current policy settings are not affordable under the current fiscal strategy, and either changes to policy settings or service levels, or additional capital investment, will be required. Given other concurrent demands for capital and operating funding, any attempt to fund the scale of signalled intentions within the social assets area would have a negative impact on net debt and net worth measures.

Recent changes in the state housing and defence sectors to get better value out of existing resources and reduce future investment pressures illustrate that corrective action can significantly reduce agencies' 10-year intentions.

Financial assets

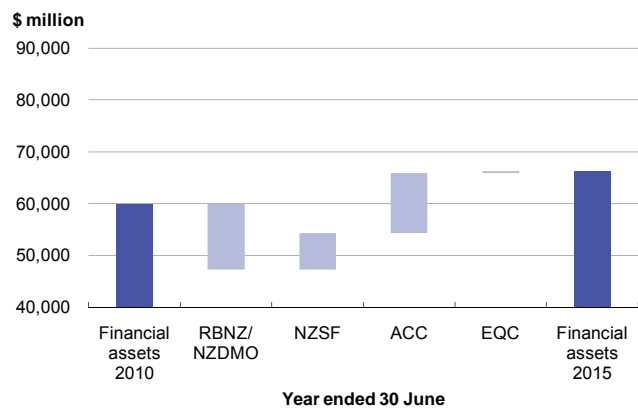
Forecast through to 2015

Figure 34 shows that financial assets are forecast to increase from \$60 billion to \$68 billion over the period.

The movement in financial assets is the result of forecast increases in market value and any capital injections from the Crown less any payments paid out of these organisations.

- ACCs financial assets are set to increase as higher ACC levies are invested and as the ACC fund moves towards becoming fully funded.
- NZSF increases are owing to forecast investment returns. The Government has temporarily ceased making contributions to NZSF until such time as sufficient operating surpluses are achieved.
- RBNZ assets were built up during the global financial crisis and are expected to unwind as the economy stabilises. NZDMO financial assets decrease in line with NZDMO's standard forecasting assumptions. The actual level of liquid assets is subject to future policy decisions.

Figure 34 – Forecast movements in financial assets



Source: The Treasury

Projections into the longer term under current policy settings

ACC is forecast to continue to build its asset base until 2019 to match liabilities, at which point the ACC levy will be able to be reduced and both assets and liabilities will continue to grow until the Scheme matures.

NZSF financial assets are expected to grow through generated returns only until 2019 when the Crown is forecast to generate a sufficient operating surplus to be able to resume contributions to the Fund.

Financial asset growth is therefore forecast to be driven largely by investment returns and a small level of retained EQC and ACC levies until NZSF contributions restart in 2019, which will then drive stronger growth in these assets into the longer term.

Commercial assets

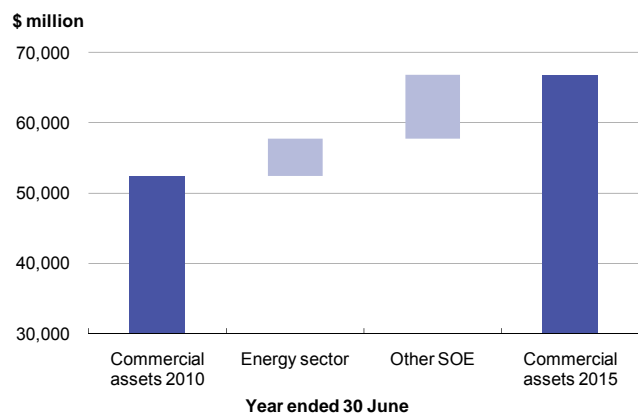
Forecast through to 2015

The physical assets held by the energy SOEs and KiwiRail form the bulk of the commercial assets held by the Crown. Figure 35 shows the expected movement in commercial assets through to 2015.

Commercial assets are being driven upwards by:

- planned investment in electricity transmission network assets, and
- proposed investment and/or forecast growth in KiwiRail, Kiwibank and Air NZ, and an overall increase in total PPE across the portfolio. This movement is after depreciation and is funded from new capital injections and from SOE surplus cash at the expense of dividends paid.

Figure 35 – Forecast movements in commercial assets



Source: The Treasury

Estimated revaluations have not been included in the forecast growth disclosed in Budget 2010. SOEs regularly revalue their assets. For example, the electricity generation assets are valued on a discounted cash flow basis of their future earnings, while KiwiRail assets are valued on cost to replace the rail network.

Projections into the longer term under current policy settings

The Government’s current policy setting is no asset sales. With the exception of processes already underway to dissolve the two non-operational SOEs (Timberlands West Coast and ECNZ), the current commercial portfolio – as defined in this *Investment Statement* – is expected to remain unchanged.

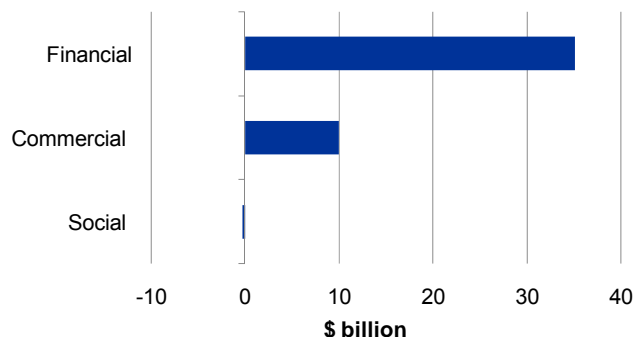
Crown liabilities

Over the next five years, total liabilities are forecast to increase in value by \$44.8 billion (about 34.9%) as shown in Figure 36.

Borrowings are forecast to increase by \$36.9 billion of which \$32 billion relates to additional Government bonds as a result of an operating deficit being run over the period. The remaining increase in the borrowings value is owing to a higher level of SOE borrowings (including Kiwibank). By 2015 the Government will have \$106.7 billion of debt which will require annual interest payments of \$5.6 billion. Interest payments will take up 8.3% of the annual tax take.

Claims liability for ACC is forecast to increase by \$8.4 billion owing to the Scheme maturing.

Figure 36 – Changes in liabilities over the forecast period (2010 to 2015)



Source: The Treasury

Balance sheet risks

The Crown's future fiscal position is exposed to risk owing to the uncertainty around future revenues, expenses and the values of assets and liabilities.

A recent model-based analysis of aggregate Crown risk found that the uncertainty surrounding tax revenue and social expenditure represented just over two-thirds of the Crown's aggregate financial risk, with the remainder attributable to volatility in conventional balance sheet assets and liabilities.⁴⁰ It is unsurprising that the uncertainty of future tax revenue is a key source of fiscal risk since it is the Crown's main source of financing. As the tax base rests on New Zealanders' capacity to earn, fiscal risk is intertwined with broader macroeconomic risk. Government expenditure, while controllable to a large extent, has its own set of risks: transfer payments are indexed to economic variables such as inflation; the cost of public services is impacted by the wider labour market; and there are myriad pressures that create uncertainty about future expenses (eg, the fiscal cost associated with the Canterbury earthquake). In extreme stress events such as a financial crisis, there may be pressure for the Crown to take on risks that are currently borne by the private sector.

The recent domestic recession and global financial crisis are a reminder that major economic shocks do occur and can put profound pressure on public finances. It is likely that one or more sharply negative economic shocks will occur at some point over a multi-

⁴⁰ Timothy Irwin and Oscar Parkyn (2009) "Improving the Management of the Crown's Exposure to Risk", New Zealand Treasury Working Paper 09/06. See: <http://www.treasury.govt.nz/publications/research-policy/wp/2009/09-06/>

decade horizon. Providing a resilient buffer against potential future shocks is part of the rationale for ensuring the strength and sound management of the Crown balance sheet.

A more detailed discussion of fiscal risk can be found in the HYEPU 2010 which includes information on forecasting risks and scenarios, specific fiscal risks arising from policy decisions and some discussion of “tail” risks such as large economic shocks and natural disasters. Below is a qualitative discussion of the major sources of risk to the values of assets and liabilities.

The volatility and uncertainty of asset and liability values have direct implications for the Crown’s financial resources, and therefore how much tax revenue needs to be levied. For example, a 0.1 percentage point higher (or lower) return on the Crown’s \$110 billion financial and commercial asset portfolio equates to higher (or lower) revenue of \$110 million per annum. Debt can be thought of as deferred taxation, and a higher risk premium on Crown debt means greater debt-servicing costs. Obviously higher returns tend to be associated with higher risk, and thus it is important that the mix of assets and liabilities strikes an appropriate balance – generating sufficient returns (or reasonable cost) for the risk taken on behalf of taxpayers and ensuring that the Crown does not unduly expose itself to the risk of financial distress.

A conventional approach to asset and liability risk management is to assess broad classes of risk such as market risk, credit risk, liquidity risk, operational risk and business risk. Different parts of the balance sheet are exposed to these risks to different degrees. At present there is no systematic quantification of these risks and indeed some types of risk may not be possible to measure or even know about (so-called “black swans”).

Much risk management is delegated to individual entities with strong reliance placed on transparency and strong governance with accountability to boards and Ministers. This approach tries to ensure that risks are managed by those with the best incentives, information and capability. Institutional design and clear accountabilities are important in this respect. For instance, SOEs are limited-liability companies that operate on a commercial basis without a Crown guarantee. Nonetheless, the exposure to risk as an investor in assets is ultimately governed by decisions taken by the Government and borne by taxpayers. The Government is committed to improving the understanding and management of Crown risk as part of the overall focus on the balance sheet.

Market risk

Market risk arises from movements in market variables, in particular relating to interest and exchange rates and equity prices.

The sensitivity of the value of financial instruments to key market movements is shown in the table below. A caveat is that these measures only partially capture Crown risk because they quantify the impact only on financial instruments such as bonds, shares and derivatives. The commercial portfolio is also exposed to these factors through the impact on commercial transactions (eg, exchange rate impact on export sales) and the valuation of commercial investments. Moreover, the drivers of market risk can be correlated as they are influenced by common domestic and global factors and economic variables such as inflation.

Sensitivity of financial portfolio to market movements

| Scenario | Impact on net worth, 30 June 2010 (\$billion) |
|--|---|
| NZ interest rates decline by 1% (100 basis points) | (0.5) |
| NZ exchange rate depreciates by 10% | (0.3) |
| Share prices fall by 10% | (1.2) |

Source: *Financial Statements of the Government of New Zealand, 2010*

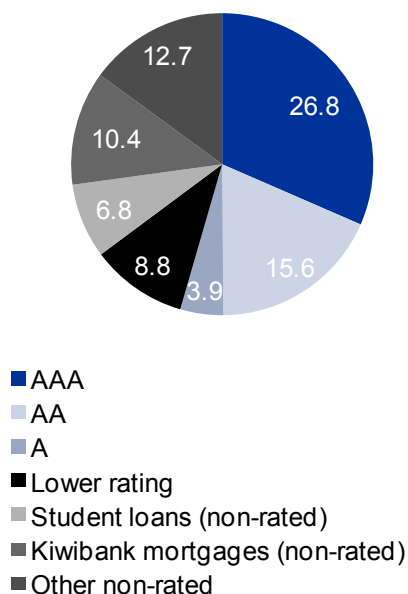
The Crown’s exposure from normal market volatility is manageable from an aggregate perspective. The low net sovereign debt position limits the impact from interest rates, although debt is forecast to rise over the next few years. The NZDMO does not issue net foreign currency-denominated debt which limits risks from the exchange rate. The Crown is exposed to equity price movements mainly owing to the investments of the CFIs – which can suffer losses as well as reap upside gain.

Credit risk

Credit risk refers to the risk that a counterparty will default on their contractual obligations resulting in a financial loss to the Crown.

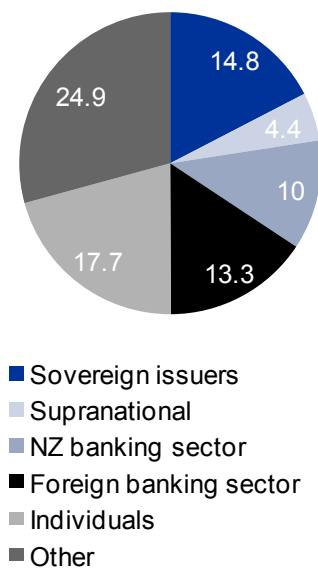
Credit exposures are managed by individual entities with information collected centrally and reported in the notes to the financial statements. The figures below show that around half of credit exposure is to creditors with a credit rating of AAA, AA and A. The remainder is mostly with counterparties that are not rated, in particular Kiwibank mortgages and student loans. Kiwibank is a registered bank subject to prudential regulation. The management of the student loan portfolio is discussed earlier in Section 3.

Figure 37 – Credit exposure by credit rating, 30 June 2010 (\$billion)



Source: The Treasury

Figure 38 – Credit exposure by sector, 30 June 2010 (\$billion)



Source: The Treasury

Liquidity risk

Liquidity risk refers to the risk that an entity will encounter difficulty in meeting financial obligations as they fall due.

On a day-to-day basis, individual entities generally manage their own liquidity. The NZDMO is the primary manager of the core Crown's liquidity by managing cash flows and ensuring sufficient bonds are issued to meet funding requirements. SOEs borrow on their own behalf, without Crown guarantee, and generally aim to have investment-grade credit ratings.

Major liquidity problems for sovereigns generally arise when they cannot raise debt at a reasonable price because market sentiment doubts the credibility of a government's commitment to fiscal discipline. Therefore the Government's fiscal strategy of keeping net debt within prudent limits, and maintaining a high credit rating, is a key part of ensuring that the Crown is able to access market funding as required in the future.

Operational risk

Operational risk is the risk of loss which could result from inadequate or failed internal processes or systems.

The public sector comprises a large and complex set of entities and businesses each with a unique set of operational challenges. The Government does not attempt to centrally measure or manage operational risk and is reliant on individual Ministers, chief executives and boards to be accountable for managing most operational risks. Generally, the potential financial losses from operational failures are thought to be manageable, partly because of the diversification entailed by the range of entities and businesses.

Business risk

Business risk refers to the residual sources of risk affecting the performance of an enterprise, such as from changes in the commercial environment.

The commercial portfolio includes many business risks including the volatility of international coal prices (Solid Energy), demand for international air travel (Air NZ), rainfall levels (Meridian), regulatory factors (Transpower) and technology substitution (NZ Post).

In addition, the Government's various social assets contain business risk relating to both demand and supply factors. In particular, all governments face an inherent challenge to distinguish between investments with a genuine social payoff and those in which there is pressure for cost escalation owing to a lack of innovation or insider capture.

The Government is focusing on ensuring that capital allocation is directed toward investments and projects in which there is a return commensurate with the degree of business risk. Specific initiatives include stronger monitoring and governance for SOEs and improving the core Crown's capital budgeting processes.

5

Investment Intentions

The previous sections have been largely descriptive, covering what assets and liabilities are on the Crown's balance sheet, how they are performing and how they are forecast to change on the basis of current policy settings. In contrast, this section sets out the Government's high-level intentions, or strategy, for how the composition of the balance sheet will be shaped over time and how the performance of the individual components will be improved.

The Government's high-level investment intentions are summarised by the following five themes:

- rebuilding resilience
- reducing risk exposures
- sharpening incentives to use existing capital well
- introducing private sector capital and disciplines where appropriate, and
- prioritising capital to its highest value use.

Rebuilding resilience

The Crown's balance sheet provides a buffer to shocks and to future fiscal pressures such as an ageing population. The impact of the recent recession and other shocks, such as the Canterbury earthquake, has been mitigated by the Crown's strong fiscal position, but that buffer has now been reduced.

The Government intends to rebuild the buffer as fast as practicable. In particular:

- The Government's fiscal strategy is to return to surplus as quickly as is practical, thereby minimising the rise in net debt and reduction in net worth.
- Once the Government has returned to surplus, debt repayments and contributions to NZSF (building up financial assets as a way of pre-funding future fiscal pressures) will resume.
- Liabilities that can be specifically insured against, such as ACC liabilities other than for residual claims relating to the Non-Earners' Account, should be fully funded over time (ie, sufficient assets to cover associated liabilities).

Reducing risk exposures

At any point in time, the Crown is exposed to a range of fiscal risks. In many cases, it is entirely appropriate for the Crown to bear these risks – eliminating risk is neither desirable nor practical. But in some cases, the Crown is either not best placed to manage a particular risk, or the exposure represents undue risk to the Crown.

The Government intends to reduce specific risk exposures that meet these criteria as conditions permit. Particular examples are:

- The Retail Deposit Guarantee Scheme introduced in late 2008 has now largely ended (with a limited extension now operating), limiting the taxpayers' exposure to finance company failures.
- South Canterbury Finance's assets will be disposed of as fast as practicable consistent with getting most value for taxpayers.

More generally, the Government's focus on rebalancing the economy and increasing national savings will also reduce the wider risks to the Crown's tax base and fiscal position.

Sharpening incentives to use existing capital well

The Government has a stewardship role in delivering good-quality services efficiently. The Government has a high expectation for all users of Crown capital to make efficient use of capital and ensure the services delivered from that capital are effective.

The Government intends to continue using three broad levers to sharpen incentives: greater transparency in both performance and future intentions; higher expectations on performance and efficiency; and more consistent exposure to the cost of capital. In particular:

- *Greater transparency.* Recent steps include the *National Infrastructure Plan*, the *COMU APR*, and this *Investment Statement*. Capital-intensive agencies are now reporting on 10-year capital intentions. In the SOE portfolio, transparency has been increased via a continuous disclosure regime and annual public meetings for the larger companies.
- *Higher expectations.* The Government has explicitly focused on the performance of assets on balance sheet. For the commercial portfolio, shareholding Ministers have set high performance expectations, including an expectation for higher and more consistent dividends.
- *Exposure to the cost of capital.* The rules for agencies' capital asset management have been tightened over the past year, including a new standard for capital business cases. The rules for capital charge are currently being reworked to apply to a wider range of agencies and so that the correct incentives apply. Changes are being investigated for depreciation funding for very large assets.

Introducing private sector capital and disciplines where appropriate

In addition to sharpening incentives within the public sector, private sector disciplines are an additional lever that can improve performance in some circumstances. The Government is pragmatic in wanting to use the full range of levers to improve performance.

The Government will continue to explore where private sector capital and disciplines are appropriate. In particular:

- Increasing contestability is being investigated in ACC and social housing.
- PPPs introduce outside expertise and risk-sharing. Currently projects are underway for Wiri prison and being investigated for schools.
- All agencies are being asked to consider whether efficiency gains can be made by leasing rather than owning some of their assets.
- The Government will consider whether its current policy of no changes in public ownership in the commercial portfolio is still appropriate for New Zealand. Any change would be announced before the 2011 election.

Prioritising capital to its highest value use

The Government places highest priority on ensuring social services and infrastructure can be delivered to an appropriate quality level. However, given fiscal constraints, capital injections will be less common than in recent years and more agencies will need to live within current balance sheets. The second priority is liquid investments that can be employed when shocks occur. Finally, illiquid investments, in particular further investment in SOEs, are the lowest priority.

The Government's decisions through Budget and other processes will reflect the following priorities:

- Priorities in upcoming Budgets are key social infrastructure – with a focus on investments that will transform the efficiency, effectiveness and sustainability of public services – and a few specific aspects of economic infrastructure (namely, ultra-fast broadband and KiwiRail's turnaround plan). The Government is setting a high hurdle for business cases to justify new capital. Most areas are expected to manage within their existing capital base, and *all* State agencies will need to deliver better value from existing capital.
- Agencies are being asked to consider where disposal of surplus assets (eg closed schools, surplus NZDF properties) can be made without significant impact on service delivery, and how the process of disposals can be sped up. Any capital released can be recycled to higher priority parts of the balance sheet.
- For the financial portfolio, priorities are restoring reserves and resuming contributions to NZSF as soon as practical.
- For the commercial portfolio, the priority is generating returns for the owners that can be used for higher priority activities. Free cash flows are expected to be directed primarily to dividend payments rather than new investment and Crown capital injections into SOEs will face a very high hurdle.

Glossary of Terms

| | |
|-------------|---|
| ACC | Accident Compensation Corporation |
| ACP | Animal Control Products Limited |
| AES | Annual Enterprise Survey |
| Air NZ | Air New Zealand Limited |
| Airways | Airways Corporation of New Zealand Limited |
| APR | Annual Portfolio Report (COMU) |
| CFIs | Crown Financial Institutions, which are ACC, EQC, GSF, NPF and NZSF |
| CFISnet | Crown Financial Information System |
| COMU | Crown Ownership Monitoring Unit, the Treasury |
| Corrections | Department of Corrections |
| CPI | Consumer Price Index |
| CRIs | Crown Research Institutes |
| DBH | Department of Building and Housing |
| DHBs | District Health Boards |
| DOC | Department of Conservation |
| EQC | Earthquake Commission |
| Elec gen | Electricity generators |
| GAAP | Generally Accepted Accounting Practice |
| Genesis | Genesis Power Limited |
| GDP | Gross Domestic Product |
| GPS | Government Policy Statement on Land Transport Funding |
| GSF | Government Superannuation Fund |
| HNZC | Housing New Zealand Corporation |
| IMF | International Monetary Fund |
| IRD | Inland Revenue Department |
| IRR | Income Related Rent |
| ITPs | Institutes of Technology and Polytechnics |
| Justice | Ministry of Justice |
| Kordia | Kordia Group Limited |
| KPIs | Key Performance Indicators |
| KRG | KiwiRail Group |
| Landcorp | Landcorp Farming Limited |
| LINZ | Land Information New Zealand |
| LML | Learning Media Limited |
| Meridian | Meridian Energy Limited |
| MetService | Meteorological Service of New Zealand Limited |
| MoD | Ministry of Defence |
| MoE | Ministry of Education |
| MoH | Ministry of Health |
| MoT | Ministry of Transport |
| MRP | Mighty River Power Limited |
| MSD | Ministry of Social Development |
| NDF | National Disaster Fund |
| NLTF | National Land Transport Fund |
| NPF | National Provident Fund |
| NZDF | New Zealand Defence Force |
| NZDMO | New Zealand Debt Management Office, the Treasury |
| NZIFRS | New Zealand International Financial Reporting Standards |

| | |
|--------------|--|
| NZ Post | New Zealand Post Limited |
| NZSF | New Zealand Superannuation Fund |
| NZTA | New Zealand Transport Agency |
| OECD | Organisation for Economic Co-operation and Development |
| Police | New Zealand Police |
| PPE | Property, plant and equipment |
| QV | Quotable Value Limited |
| RBNZ | Reserve Bank of New Zealand |
| S&P | Standard & Poor's |
| SCI | Statement of Corporate Intent |
| Scion | New Zealand Forest Research Institute Limited |
| SOEs | State-Owned Enterprises |
| SOI | Statement of Intent |
| Solid Energy | Solid Energy New Zealand Limited |
| SSC | State Services Commission |
| TEIs | Tertiary Education Institutions |
| Te Papa | Museum of New Zealand Te Papa Tongarewa |
| Transpower | Transpower New Zealand Limited |

Annex 1

Forecast Statement of Movement in Assets as at 30 June

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|--|----------------|----------------|----------------|----------------|----------------|
| | \$m | \$m | \$m | \$m | \$m |
| Opening balance | 223,355 | 232,312 | 238,619 | 240,970 | 252,722 |
| <i>Property, plant & equipment</i> | | | | | |
| - Net additions | 8,162 | 7,628 | 7,024 | 6,785 | 6,493 |
| - Revaluations | (41) | - | - | - | - |
| - Depreciation | (3,756) | (4,008) | (4,146) | (4,225) | (4,360) |
| - Other changes | (367) | (457) | (229) | 165 | (249) |
| Capital allowance | 292 | 732 | 707 | 981 | 1,170 |
| <i>Advances</i> | | | | | |
| - Student loans (issued) | 1,547 | 1,558 | 1,580 | 1,602 | 1,622 |
| - Student loans (repaid) | (791) | (878) | (997) | (1,101) | (1,213) |
| - Student loans (other changes) | (307) | (278) | (260) | (247) | (228) |
| - KiwiBank | 687 | 3,275 | 604 | - | - |
| - Other changes in advances | 59 | 35 | (100) | (28) | 12 |
| <i>Other financial assets</i> | | | | | |
| - NZDMO/Reserve Bank | (176) | (5,675) | (6,367) | 3,273 | (5,385) |
| - NZS Fund | 1,403 | 1,236 | 1,340 | 1,456 | 1,583 |
| - ACC | 3,538 | 2,621 | 2,924 | 3,166 | 3,357 |
| - Other changes | (1,553) | 318 | 36 | (247) | 565 |
| Other assets | 260 | 200 | 235 | 172 | 184 |
| Closing balance | 232,312 | 238,619 | 240,970 | 252,722 | 256,273 |

Source: The Treasury

Forecast Statement of Movement in Liabilities as at 30 June

| | 2011 | 2012 | 2013 | 2014 | 2015 |
|-----------------------------|----------------|----------------|----------------|----------------|----------------|
| | \$m | \$m | \$m | \$m | \$m |
| Opening balance | 128,367 | 146,503 | 156,915 | 161,509 | 172,338 |
| <i>Borrowings</i> | | | | | |
| Government stock issued | 14,011 | 13,860 | 12,774 | 9,307 | 9,761 |
| Government stock repayments | - | (7,982) | (9,987) | - | (9,934) |
| Other borrowings | 2,132 | 3,435 | (27) | 22 | (454) |
| ACC liability | 1,959 | 1,351 | 1,530 | 1,680 | 1,870 |
| GSF liability | (503) | (323) | (282) | (252) | (228) |
| Other changes | 537 | 71 | 586 | 72 | (204) |
| Closing balance | 146,503 | 156,915 | 161,509 | 172,338 | 173,149 |

Source: The Treasury

Historic and Forecast Balance Sheet Information

| Nominal GDP (\$ million) | 134,318 | 144,902 | 154,069 | 161,591 | 171,650 | 182,478 | 184,546 | 189,295 | 202,398 | 213,495 | 225,232 | 236,656 | 247,667 |
|---|---------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|
| June Years | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| \$ millions | ← OLD GAAP ¹ → | | | | ← NZ IFRS → | | | | | | | | |
| Assets | | | | | | | | | | | | | |
| Cash and cash equivalents | 2,732 | 3,450 | 3,710 | 4,168 | 4,162 | 3,804 | 6,268 | 7,774 | 9,687 | 9,624 | 9,597 | 9,938 | 10,201 |
| Receivables | 10,143 | 10,587 | 10,883 | 14,474 | 12,057 | 14,158 | 14,619 | 13,884 | 14,970 | 14,026 | 13,563 | 13,530 | 13,886 |
| Marketable securities, deposits and derivatives in gain | 16,572 | 16,190 | 22,166 | 28,126 | 33,190 | 41,189 | 45,708 | 43,687 | 42,375 | 38,641 | 34,382 | 38,970 | 35,504 |
| Share investments | 4,734 | 8,446 | 10,896 | 15,394 | 13,581 | 12,964 | 11,160 | 12,179 | 13,704 | 16,945 | 19,627 | 22,379 | 25,346 |
| Advances | 6,300 | 7,445 | 8,536 | 8,758 | 10,728 | 12,948 | 15,604 | 18,447 | 19,642 | 23,354 | 24,181 | 24,407 | 24,600 |
| Inventory | 840 | 888 | 946 | 907 | 826 | 964 | 1,082 | 1,160 | 1,245 | 1,293 | 1,338 | 1,369 | 1,421 |
| Other assets | 576 | 510 | 453 | 898 | 1,527 | 1,663 | 1,630 | 1,661 | 1,705 | 1,703 | 1,709 | 1,705 | 1,703 |
| Property, plant & equipment | 52,667 | 57,940 | 67,494 | 79,441 | 95,598 | 103,329 | 110,135 | 113,330 | 117,328 | 120,491 | 123,140 | 125,865 | 127,749 |
| Equity accounted investments | 4,212 | 4,367 | 5,010 | 5,475 | 7,001 | 8,065 | 8,777 | 9,049 | 9,345 | 9,554 | 9,773 | 9,976 | 10,173 |
| Intangible assets and goodwill | 1,075 | 849 | 737 | 630 | 1,677 | 1,751 | 2,168 | 2,184 | 2,369 | 2,464 | 2,429 | 2,371 | 2,308 |
| Forecast for new capital spending | .. | .. | .. | .. | .. | .. | .. | .. | 292 | 1,024 | 1,731 | 2,712 | 3,882 |
| Top-down capital adjustment | .. | .. | .. | .. | .. | .. | .. | .. | (350) | (500) | (500) | (500) | (500) |
| Total assets | 99,851 | 110,672 | 130,831 | 158,271 | 180,347 | 200,835 | 217,151 | 223,355 | 232,312 | 238,619 | 240,970 | 252,722 | 256,273 |
| Liabilities | | | | | | | | | | | | | |
| Issued currency | 2,895 | 3,009 | 3,197 | 3,362 | 3,444 | 3,530 | 4,005 | 4,020 | 4,137 | 4,344 | 4,561 | 4,789 | 5,028 |
| Payables | 9,208 | 9,848 | 11,371 | 12,469 | 8,077 | 10,895 | 9,139 | 9,931 | 9,562 | 10,092 | 10,226 | 10,705 | 11,117 |
| Deferred revenue | .. | .. | .. | .. | 966 | 1,292 | 1,426 | 1,628 | 1,436 | 1,360 | 1,320 | 1,298 | 1,298 |
| Borrowings | 38,285 | 36,825 | 36,864 | 39,427 | 41,898 | 46,110 | 61,953 | 69,733 | 85,876 | 95,189 | 97,949 | 107,278 | 106,651 |
| Insurance liabilities | 9,155 | 9,347 | 11,384 | 12,715 | 17,418 | 20,484 | 26,567 | 27,131 | 29,604 | 30,464 | 32,001 | 33,685 | 35,557 |
| Retirement plan liabilities | 13,857 | 13,542 | 14,952 | 15,231 | 7,161 | 8,257 | 8,993 | 9,940 | 9,436 | 9,113 | 8,832 | 8,580 | 8,352 |
| Provisions | 2,670 | 2,638 | 3,080 | 3,664 | 4,556 | 4,753 | 5,553 | 5,984 | 6,452 | 6,353 | 6,620 | 6,003 | 5,146 |
| Total liabilities | 76,070 | 75,209 | 80,848 | 86,868 | 83,520 | 95,321 | 117,636 | 128,367 | 146,503 | 156,915 | 161,509 | 172,338 | 173,149 |
| Net Worth | 23,781 | 35,463 | 49,983 | 71,403 | 96,827 | 105,514 | 99,515 | 94,988 | 85,809 | 81,704 | 79,461 | 80,384 | 83,124 |

| Nominal GDP (\$ million) | 134,318 | 144,902 | 154,069 | 161,591 | 171,650 | 182,478 | 184,546 | 189,295 | 202,398 | 213,495 | 225,232 | 236,656 | 247,667 |
|---|---------------------------|-------------|-------------|-------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|--------------|
| June Years | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 |
| | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Actual | Forecast | Forecast | Forecast | Forecast | Forecast |
| % GDP | | | | | | | | | | | | | |
| \$ millions | ← OLD GAAP ¹ → | | | | ← NZ IFRS → | | | | | | | | |
| Assets | | | | | | | | | | | | | |
| Cash and cash equivalents | 2.0 | 2.4 | 2.4 | 2.6 | 2.4 | 2.1 | 3.4 | 4.1 | 4.8 | 4.5 | 4.3 | 4.2 | 4.1 |
| Receivables | 7.6 | 7.3 | 7.1 | 9.0 | 7.0 | 7.8 | 7.9 | 7.3 | 7.4 | 6.6 | 6.0 | 5.7 | 5.6 |
| Marketable securities, deposits and derivatives in gain | 12.3 | 11.2 | 14.4 | 17.4 | 19.3 | 22.6 | 24.8 | 23.1 | 20.9 | 18.1 | 15.3 | 16.5 | 14.3 |
| Share investments | 3.5 | 5.8 | 7.1 | 9.5 | 7.9 | 7.1 | 6.0 | 6.4 | 6.8 | 7.9 | 8.7 | 9.5 | 10.2 |
| Advances | 4.7 | 5.1 | 5.5 | 5.4 | 6.2 | 7.1 | 8.5 | 9.7 | 9.7 | 10.9 | 10.7 | 10.3 | 9.9 |
| Inventory | 0.6 | 0.6 | 0.6 | 0.6 | 0.5 | 0.5 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Other assets | 0.4 | 0.4 | 0.3 | 0.6 | 0.9 | 0.9 | 0.9 | 0.9 | 0.8 | 0.8 | 0.8 | 0.7 | 0.7 |
| Property, plant & equipment | 39.2 | 40.0 | 43.8 | 49.2 | 55.7 | 56.6 | 59.7 | 59.9 | 58.0 | 56.4 | 54.7 | 53.2 | 51.6 |
| Equity accounted investments | 3.1 | 3.0 | 3.3 | 3.4 | 4.1 | 4.4 | 4.8 | 4.8 | 4.6 | 4.5 | 4.3 | 4.2 | 4.1 |
| Intangible assets and goodwill | 0.8 | 0.6 | 0.5 | 0.4 | 1.0 | 1.0 | 1.2 | 1.2 | 1.2 | 1.2 | 1.1 | 1.0 | 0.9 |
| Forecast for new capital spending | .. | .. | .. | .. | .. | .. | .. | .. | 0.1 | 0.5 | 0.8 | 1.1 | 1.6 |
| Top-down capital adjustment | .. | .. | .. | .. | .. | .. | .. | .. | (0.2) | (0.2) | (0.2) | (0.2) | (0.2) |
| Total assets | 74.3 | 76.4 | 84.9 | 97.9 | 105.1 | 110.1 | 117.7 | 118.0 | 114.8 | 111.8 | 107.0 | 106.8 | 103.5 |
| Liabilities | | | | | | | | | | | | | |
| Issued currency | 2.2 | 2.1 | 2.1 | 2.1 | 2.0 | 1.9 | 2.2 | 2.1 | 2.0 | 2.0 | 2.0 | 2.0 | 2.0 |
| Payables | 6.9 | 6.8 | 7.4 | 7.7 | 4.7 | 6.0 | 5.0 | 5.2 | 4.7 | 4.7 | 4.5 | 4.5 | 4.5 |
| Deferred revenue | .. | .. | .. | .. | 0.6 | 0.7 | 0.8 | 0.9 | 0.7 | 0.6 | 0.6 | 0.5 | 0.5 |
| Borrowings | 28.5 | 25.4 | 23.9 | 24.4 | 24.4 | 25.3 | 33.6 | 36.8 | 42.4 | 44.6 | 43.5 | 45.3 | 43.1 |
| Insurance liabilities | 6.8 | 6.5 | 7.4 | 7.9 | 10.1 | 11.2 | 14.4 | 14.3 | 14.6 | 14.3 | 14.2 | 14.2 | 14.4 |
| Retirement plan liabilities | 10.3 | 9.3 | 9.7 | 9.4 | 4.2 | 4.5 | 4.9 | 5.3 | 4.7 | 4.3 | 3.9 | 3.6 | 3.4 |
| Provisions | 2.0 | 1.8 | 2.0 | 2.3 | 2.7 | 2.6 | 3.0 | 3.2 | 3.2 | 3.0 | 2.9 | 2.5 | 2.1 |
| Total liabilities | 56.6 | 51.9 | 52.5 | 53.8 | 48.7 | 52.2 | 63.7 | 67.8 | 72.4 | 73.5 | 71.7 | 72.8 | 69.9 |
| Net Worth | 17.7 | 24.5 | 32.4 | 44.2 | 56.4 | 57.8 | 53.9 | 50.2 | 42.4 | 38.3 | 35.3 | 34.0 | 33.6 |

¹ These numbers are based on the published Financial Statements of the Government as at 30 June and may differ to other numbers used in the Investment Statement which may be restated on a NZ IFRS basis.

Source: The Treasury