28th February 2019

Submission on the Productivity Commission's "Local government funding and financing" paper – Guardians of New Zealand Superannuation

Kia ora, thank you for the opportunity to comment on the Productivity Commission's (the **Commission's**) "Local government funding and financing" issues paper. The Guardians of New Zealand Superannuation (the **Guardians**) is the manager and administrator of the New Zealand Super Fund (the **Fund**). The Guardians is a member of Infrastructure New Zealand (**INZ**) and our submission is lodged within the extended deadline (28th February 2019) negotiated for INZ members.

1. Summary

- As an experienced global investor and a significant player in New Zealand's capital markets and direct investment landscape, the Guardians is well positioned to comment on the direction of financing and funding reform relating to local government, primarily in the area of infrastructure investment.
- We broadly agree with the Commission's analysis of the issues and limitations facing the current local government financing and funding framework, in a system where limits on debt and rate increases are at odds with the increased spending needed to support, or as a result of, unprecedented growth.
- Given the scope, responsibilities and geographical boundaries of local government (i.e. a grand solution) is out of the scope of this inquiry, we focus our comments in this submission on practical measures that we believe can help local governments relieve pressure and increase financing and funding options – in the current framework.
- We have identified five types of projects, within the local government sector, which are in line with the Guardians' investment approach and where we believe investment by the Fund has the potential to add value to service delivery and infrastructure provision:
    - growth infrastructure;
    - urban development and regeneration;
    - asset divestment/recycling;
    - aggregation of infrastructure assets-services; and
    - major renewal/replacement.
- The Guardians has developed an overarching partnership framework, Public-Public Investment (**PPI**), for approaching investment in potential large-scale domestic development projects (e.g. infrastructure and property development). PPI is centred around genuine alignment between the Guardians and the government on priorities, objectives, governance with the Fund financing, delivering and potentially owning and operating the project/asset (along with the requisite capital/capability partners).
- We outline two potential applications of the PPI framework in the local government context i.e. the Infrastructure Funding and Financing (**IFF**) model being progressed by Treasury, and the Private Development Corporation (**PDC**) model, which has arisen out of the Guardians' work on potential real estate development opportunities. Both these financing models require regulatory change.
- The IFF model aims to attract alternative funding, to bring forward viable infrastructure projects and improve housing affordability. The model will be structured to address councils' borrowing constraints (ring-fence project revenues and risks from the relevant Council's balance sheet) and behavioural issues (viability becomes the main determinant of whether projects proceed). It evolves the model used by Crown

Infrastructure Partners, using legislative change to create an approach that is cleaner, more scalable and more appealing to investors.

- The PDC concept involves bundling the components of a real estate development (i.e. enabling infrastructure and the development itself – design, construction, financing and ownership) into a single partnership based entity.
- For an alternative financing model to result in investment (or co-investment) by the Fund, we would require defined, project-specific revenues generating a long-tern commercial return. To achieve this, funding tools will likely need to have the following characteristics:
    - long-term ring-fenced returns;
    - simple, transparent and easily communicated;
    - clarity of revenue and returns;
    - clear assessment and allocation of risk; and
    - cash flow flexibility to match the needs of the financing model.

2. New Zealand Super Fund (the Fund)

The Fund was established in 2001 to invest money, on behalf of the Government, to help pay for the increased cost of universal superannuation entitlements in the future as the population ages. The Guardians manage the Fund. As at 30 June 2018, the Fund totalled $39b, with approximately $6b invested domestically.

The Guardians' mission is to "*maximise the Fund's return over the long-term, without undue risk, so as to reduce future New Zealanders' tax burden*". The Guardians operates within a legislative mandate that requires it to "*invest the Fund on a prudent, commercial basis and, in doing so, must manage and administer the Fund in a manner consistent with:*

- *best practice portfolio management;*
- *maximising return without undue risk to the Fund as a whole; and*
- *avoiding prejudice to New Zealand's reputation as a responsible member of the world community.*"

The Fund has statutory independence from the Government, by way of a 'double arm's length' Crown entity structure, which encourages a focus on long-term objectives. In 2009, the Guardians received Ministerial Direction to appropriately identify and consider opportunities to increase its allocation to New Zealand assets, subject to the Guardians' statutory mandate, in which the promotion of domestic infrastructure investment is specifically noted.

The Fund is uniquely suited to investing directly in large New Zealand projects; it is local and Crown owned, large-scale relative to other NZ investors, has a long term investment horizon and has predictable liquidity arrangements that can match intergenerational investments (like infrastructure).

The Fund requires a commercial return from each investment that is commensurate with the risk taken, and is prohibited from owning a controlling interest in an operating company. We look for investment opportunities with a defensible competitive advantage, able and trustworthy management, and where the Guardians can take an active governance role. In terms of investment size in New Zealand direct investments, the Fund generally invests between $100 and $500 million, to achieve a 20 – 50% equity ownership in each investment.

Large-scale domestic infrastructure opportunities fit within the Fund's mandate. The Guardians recently worked alongside Canadian infrastructure investor CDPQ to explore financing, designing, building, operating and owning the Auckland Light Rail Project. The Guardians has also submitted a KiwiBuild 'Invitation to Pitch' proposal to partner with the Crown and off-site manufacturers (**OSM**) to deliver large scale, turnkey KiwiBuild projects. Finally, the Guardians has established an internal investment hub to work with partners to facilitate (or create) large, domestic opportunities that the Fund is uniquely placed to invest in (e.g. infrastructure projects) because of our endowments and attributes. The hub work is relationship-based and focuses on partnering and/or co-investing with aligned parties such as local government, Iwi/Māori, and the Crown. Further information about the Guardians and the Fund can be found at www.nzsuperfund.nz.

3. Reason for Submission

As both an experienced global investor and a significant player in New Zealand's capital markets and direct investment landscape, the Guardians is well positioned to comment on the direction of financing and funding reform relating to local government, primarily in the area of infrastructure investment. This submission also reflects the Guardians' infrastructure investment expertise and our recent experience in dealing with both the Crown and the local government sector as a prospective investor in the Auckland Light Rail project, KiwiBuild, the Christchurch rebuild, and partnership investment in residential development at Hobsonville, Auckland.

The Guardians is undertaking considerable work to develop new approaches to funding and financing of infrastructure development, in order for the Fund to invest in New Zealand infrastructure projects. Current financing and funding arrangements effectively represent a barrier to New Zealand tapping the investment capital, and ability to access international expertise, which the Guardians can assist in providing. Therefore, the Guardians welcomes this inquiry, as an opportunity to advance the discussion required to develop alternative financing and funding models and accelerate the development of New Zealand's infrastructure.

This submission outlines the types of local government investment projects the Fund is interested in, and suited to, and some financing models the Guardians is working on to realise potential investment opportunities. We then provide an analysis of those financing models and our perspective on the funding tools necessary to support such models. We set out the principles and general characteristics we believe the tools will need to be based on, rather than propose specific revenue tools.

In our submission, we have given our views on the financing and funding issues we are in a position to comment on. While we have not set out to answer all of the questions posed by the Commission's discussion document directly, we do address the issues raised by a number of those questions.

4. General Position

The Guardians broadly agrees with the Commission's analysis of the nature and shortcomings of the current system of local government financing and funding. The Commission has accurately, in our view, identified the key cost drivers facing local government as including:

- population growth and decline;
- tourism;
- expanded responsibilities (statutory creep);
- climate change and other natural hazards;
- rising prices; and
- growth in non-core expenditure.

To this list, we would add increasing costs due to deferred maintenance and/or past under investment.

Similarly, we agree that more effective effort is required from the local government sector to manage and reduce cost pressures and structures. This will help alleviate the cost pressures facing the sector and reduce the scale of the revenue enhancement challenge. However, cost management is a necessary but not sufficient solution, particularly when it comes to cost pressures arising from high population growth – where the issues are systemic.

Local Government is significantly constrained by current financing and funding tools and models. As a result, investment levels in network and growth infrastructure are sub-optimal, in many cases, and the resulting inadequate quality of infrastructure can be a serious and material economic constraint. The Guardians shares the Government's view that this issue needs to be confronted in an integrated way. The longer the issues persist, the more entrenched the consequences will become, and the more difficult it will be to find and implement effective solutions.

In our view, designing simple, direct (user-pays or as close to as possible) funding sources is the key to unlocking alternative financing models. We provide a general principles-based policy discussion on the desired characteristics of these revenue streams (which we view as a necessary first step) rather than suggest specific revenue tools (at this stage of the inquiry process).

5. Potential Areas of Investment

There are five main areas, which have traditionally been the domain of local government (or related to the challenges faced by that sector), where we think investment by the Fund has the potential to add value to service delivery and infrastructure provision.

5.1. Growth Infrastructure

One of the key challenges facing councils in high (population) growth areas is how to finance and fund the infrastructure required to service and/or enable that growth. Because of the pressure created by growth, the affected councils tend to be operating at, or rapidly approaching, their prudential limits. While the high growth councils' Long-Term Plans (**LTP**) tend to show head room being created in the later years, year four to ten projections almost invariably materially underestimate the eventual capital programme set out in subsequent LTPs and in many instances (e.g. high growth areas) the population growth assumptions on which the LTP's rely.

There tends to be significant scale involved in the network infrastructure investment needed to enable growth (especially when it extends current urban limits) and it requires the ability to leverage the growth to create revenue streams. This scale, and the long-term horizon of investing in growth infrastructure, is a close fit with our investment approach and an area of considerable investment potential for the Fund.

Alternative financing models will increase the quantum of investment in growth infrastructure, without affecting the relevant Council's borrowing and debt metrics (credit rating/profile). The growth infrastructure at local government level that will be most consistent with the Guardians' investment approach is enabling transport, water and waste water. As with all potential investment areas, one of the key prerequisites to the Fund's involvement will be projects that provide requisite financial scale.

5.2. Urban Development and Regeneration

At an appropriate scale the Guardians has identified potential for partnership investment in the area of urban development and regeneration i.e. large-scale residential and, potentially, related community and commercial development. In the high growth council areas, growing the housing stock to meet increased demand has become a significant challenge and one which is not being met, to the extent that it has become a priority focus of public policy (at both central and local government levels).

The economics and liquidity of the necessary large-scale urban developments are a key factor in creating the shortage but also the reason such developments are a good fit with our investment approach. Increasing the potential for, and impact of, the Fund's involvement is our complementary interest in KiwiBuild (particularly utilising off-site manufacturing) and our ability to finance the enabling infrastructure (as discussed above) to unlock developments. Effectively, alongside capital, the Guardians can integrate into its approach investment that directly address the primary constraints driving the current disequilibrium between supply and demand.

5.3. Asset Divestment /Recycling

Many councils own existing large-scale pieces of economic infrastructure, for example ports and airports. There are a range of ownership arrangements and levels of control involved in this area of local government activity – ranging from relatively silent shareholding to more direct governance and, more rarely, operational influence. Periodically, councils consider the divestment of such assets (both generally and specifically). Divestment (partial or full), or recycling of assets can be used to alleviate financial and funding constraints i.e. funds raised from divestment of existing assets can be used to finance identified new critical infrastructure (important for political acceptance to clearly show what the funds from divestment will be spent on).

While asset sales are beyond the scope of the Commission's inquiry, the Guardians have both the capacity and experience (e.g. the Kiwibank transaction) to purchase public assets – so we thought it was important to include this area of potential investment in our submission. An advantage the Fund can provide to a public asset divestment/recycling is the fact that the divested portion of the asset remains in public ownership.

5.4. Aggregation of Infrastructure Assets/Services

Some local infrastructure assets, systems and/or services don't have the scale to facilitate alternative investment or financing models, at the ownership, operational and customer-facing levels. However, there is potential to aggregate assets or services to create scale and the benefits that come with it. While such aggregation could be geographically based (i.e. regional), this does not necessarily need to be a constraint.

As well as creating investable scale, aggregation has the potential to deliver other benefits related to economies of scale and scope e.g. significant cost and efficiency benefits, improved commercial discipline and service quality, and the ability to invest in innovation and growth.

For example, the potential for aggregation is currently being explored in the three waters space i.e. through the Government's 'Three Waters Review', the terms of reference for which includes "options for water services capability, funding, scale and professional governance".

5.5. Major Renewal/Replacement

Another area of potential interest identified by the Guardians is in the renewal or replacement of existing network infrastructure. Deferred maintenance and under-investment in the past, often alongside (and in some cases because of) the financial pressures of coping with population and/or tourism growth, has resulted in many councils struggling with the investment required to maintain existing infrastructure networks. The Guardians is potentially interested in investing in such projects, provided the project is large enough in scale and mechanisms available to facilitate the necessary long-term returns. It is an area where a contribution can be made to assist in addressing challenges (seemingly intractable in some cases) faced by local government through transactional models which are consistent with the Guardians' mandate to maximise long-term investment returns without undue risk to the Fund's portfolio as a whole.

6. NZSF Approach to Direct Investment

The Guardians' approach to direct investment is through partnership; both by necessity, driven by our mandate and legislative framework, and by preference. From our experience, deep and well-aligned partnerships deliver significantly higher quality outcomes than if we were to invest in a vacuum and attempt to create the necessary skills and experience.

The Guardians can bring considerable benefits to investment partnerships (with central/local government and/or the private sector) to deliver large-scale projects, many of which are unique in the New Zealand environment. These benefits include:

- large-scale committed public funding with a shared long-term (potentially intergenerational) perspective – returns belong to all New Zealanders;
- an ability to take construction and operational risk and capability to deliver efficient, transparent, value for money procurement processes;
- the ability and experience to successfully combine public and private sector processes, drivers, capital and expertise to deliver world-class infrastructure;
- known liquidity resulting in more flexible return structures and requirements e.g. avoid the necessity of near-term dividends and/or forced exit
- existing relationships with global and domestic peer funds and Iwi/Māori organisations, which can be drawn on to realise and optimise opportunities;
- involvement in large scale investments in a range of other sectors (e.g. property development), which we can leverage to achieve optimal outcomes; and
- flexibility i.e. local government partnership with the Guardians could involve co-investment but could also simply involve alignment of objectives and regulatory engagement i.e. the Guardians takes end-to-end responsibility for delivering the project (potentially with other partners).

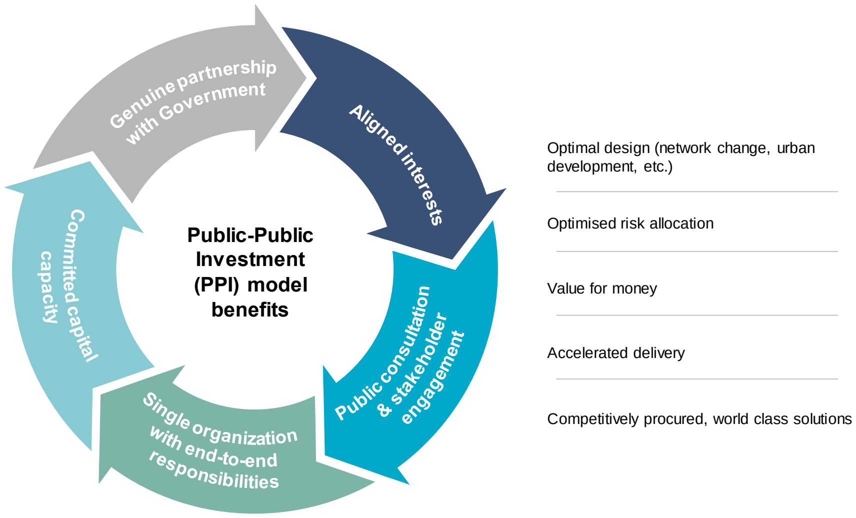
We have a principles-based framework for evaluating partnerships/opportunities, which provides a sound basis for developing the relationships necessary for successful investments and projects. These principles include:

- open, proactive engagement with partners and a strong alignment of long-term objectives/interests;
- a preference for large scale (>$100m), and scalable, investments;
- greater risk-adjusted returns than can be obtained through passive, low-cost exposure to [infrastructure] assets on the listed market;
- a preference for bilateral investment discussions; in our experience competitive bid processes can result in suboptimal commercial contractual arrangements as opposed to genuine workable partnerships;
- application of rigorous commercial discipline, best in class capability and governance, and strict adherence to process probity;
- structures through which the Guardians can take an active role e.g.in governance;
- active interest in involving Iwi/Māori organisations in investment solutions;
- transactions based on a clear and agreed understanding of risk, so that those risks can be appropriately allocated, priced and managed; and
- strong commitment to Environmental, Social and Governance (**ESG**) principles.

6.1. Public-Public Investment Framework (PPI)

In looking at various potential large-scale infrastructure and development investment opportunities in New Zealand, the Fund has developed an overarching partnership investment framework that we refer to as Public-Public Investment (**PPI**). Central to the PPI model is the principle of long-term partnership. It is through the application of the PPI framework that the Fund developed its proposed approaches to Auckland Light Rail and KiwiBuild. Given the confidential nature of the processes related to both these potential investments, we have not gone into any more detail in relation to them in this submission. We would welcome an opportunity, however, to brief the Commission, to the extent appropriate, on these practical applications of the PPI model.

From a general perspective, the PPI model is centred on the creation of a genuine partnership between the Fund and the Government (at central and/or local level), for instance, to deliver major long-term infrastructure or scale real estate development projects. The partnerships on which the investment is based encompass all aspects of the project's governance and execution, from development through to delivery and operations, and potentially (but not necessarily) co-investment. The following figure illustrates the various components of the model.



The PPI model differs markedly from the traditional Government procurement approach and from the various incarnations of Public Private Partnerships (**PPP**) models that have evolved. The following table compares these two alternatives with the PPI model across a range of critical dimensions.

	Government Procurement Model	PPI Model	PPP Model
Model definition	Government will conduct a tender process for completion of the construction and/ or design. The government retains the whole-of-life asset risk and payment is often fixed or lump sum.	Public investor and Government form a partnership and take an equity interest in the project. The public investor assumes end-to-end accountability for the project and procures best private sector delivery partners for each work package.	Typically, Government will appoint a private consortium as responsible for the full delivery of services including operating, maintenance, construction, management etc. The consortium is responsible for all capital investment.
Development			
Responsibility for planning	Government	Government Public investor	Government
Sources of financing	Government	Public investor Government	Private consortium *primarily debt financing* Government subsidies
Investment horizon	Long term	Long term	Shorter term
Delivery			
Responsibility for construction	Government	Public investor	Private consortium *ultimate fall back risk retained by government*
Timeline to get to construction phase	4-6 years	2-4 years	5-7 years
Operation			
Operation of projects	Government	Public investor	Private consortium
Shareholder(s)	Government	Public investor Government	Private consortium
Ownership of assets	Government *on balance sheet*	Public investor*	Private consortium (for c.40 years then reverts to government) *on balance sheet*
Relationship between government and private sector	Entirely government driven	Genuine and early partnership	Customer-contractor relationship

** Potential government call option*

6.2. Applications of PPI

The PPI model provides an overarching framework that guides our long-term approach to direct investment in large-scale New Zealand infrastructure or real estate projects. The specific financing model and funding tools we use will differ depending on the characteristics and structure of the individual project. In this section, we discuss how we can work with developing alternative financing models i.e. the Infrastructure Funding and Financing (**IFF**) model being developed by Treasury and the Private Development Corporation (**PDC**) model, which has arisen from our work on potential real estate development opportunities. Both these models are works-in-progress, with many details and structures are yet to be confirmed. However, they provide a good indication of how different alternative financing models would be applied, within the partnership principles of the PPI framework, to fit different circumstances and challenges. They also serve to further illustrate the point that the primary prerequisite in terms of the success of any financing or investing model is the creation of appropriate, fit for purpose, new and alternative funding tools and associated revenue streams.

6.2.1. The Infrastructure Funding and Financing Model (IFF)

The IFF model is being progressed by Treasury as part of the Government's work on improving housing affordability by enabling responsive infrastructure provision and appropriate cost allocation, including the use of project financing and access to finance capital. The IFF seeks to evolve the models used by the Housing Infrastructure Fund and Crown Infrastructure Partners through legislation to be cleaner, more scalable and more appealing to financiers. To achieve the aim of bringing forward viable infrastructure projects, the model will be structured to address councils' borrowing constraints (ring-fence the revenues and risks from the relevant Council's balance sheet) and behavioural issues (viability becomes the main determinant of whether projects proceed).

The details of the model, and the agencies and entities involved, are still being developed but essentially the IFF model involves setting up a project Special Purpose Vehicle (**SPV**), owned by local/central government and/or the private sector, to finance and deliver the project i.e. contract directly with service providers. The cost of servicing the financing (debt and/or equity) will be met by the directly charging the beneficiaries of the infrastructure a project-specific "levy". Legislative changes are needed to enable an SPV to directly charge for the cost of infrastructure and access long-term revenues. This structure is important to enable economic separation from the relevant Council i.e. so the project, and associated risks, can be considered off the Council's balance sheet (by the rating agencies).

From our perspective, the IFF model provide a useful structure for enabling external (private sector or alternative public sector) delivery of vital infrastructure i.e. accelerated provision of financially viable projects. It will be important to construct a levy mechanism that is flexible and sufficiently independent of Council and public processes to make it an attractive proposition to external investors. See section 6.3 of this submission.

6.2.2. Private Development Corporation (PDC)

The PDC model is evolving from work the Guardians (and partners) is undertaking to look at mechanisms for progressing large-scale real estate development. The concept is to bundle the components of the development (i.e. enabling infrastructure and the development itself – design, construction, financing and ownership) into a single partnership-based entity, the PDC. This is critical to get scale across many local government projects, to drive efficiencies.

In terms of the infrastructure investment necessary to facilitate the development, traditionally the domain of the local authority, the PDC would take over responsibility for planning, design financing and delivery. The PDC would effectively operate along the lines of a body corporate for the eventual residents of the development, charging them for the provision, renewal and upkeep of the services provided as well as the servicing of the debt and/or equity on which the initial (and ongoing) investment is based.

Ideally, to maximise efficiency, the PDC model would involve a potential role in minor (internal in its impact) consenting. To ensure equity, mechanisms would also need to be developed to provide for exemptions from portions of local body rates to ensure that the residents are not paying for the same service twice.

The PDC approach is deeply grounded in strong partnerships and requires cooperation, or at least an alignment of objectives, with the relevant local authority in areas such as strategic infrastructure plans/priorities and consenting. While the Fund is capable, and in the business, of providing the capital for a PDC development model, the broader areas of expertise needed are outside our core and capability and focus. Meaning, again, the development of strong, multi-disciplinary public and/or private sector partnerships will be necessary, which is what the PPI framework is designed to deliver.

As with the IFF model, a PDC could not be established under the existing local government infrastructure development framework (i.e. current legislation, regulation and/or available revenue streams).

6.3. Funding Principles

As discussed in previous sections, there are a range of financing models (both existing and being developed) that could enable successful alternative financing of local government services and, in particular, large scale infrastructure projects. However, for an alternative financing model to result in investment (or co-investment) by the Fund, we would require defined, project-specific revenues generating a long-tern commercial return (i.e. higher than our risk-adjusted cost of capital for each project).

There are a number of unique benefits the Guardians brings to the table, as a potential investment partner, some of which broaden the range of available funding options compared to other potential investment partners. These benefits have been detailed in Section 6; of particular relevance to funding options is the fact that the Fund can invest committed public funding with a synergistic long-term perspective and flexibility in the profile of returns required e.g. the capacity to sustain medium-term illiquidity.

We set out some principles below that would need to be applied to the development of funding tools to generate revenue streams consistent with the Guardians investment approach. At this stage, we do not provide suggestions of specific funding sources on which investments in the local government sector could be based, but we would welcome an opportunity to discuss with the Commission how this could most appropriately be collectively advanced, as the inquiry proceeds.

6.3.1. Long-Term Ring-Fenced Returns

To meet investors' return and risk requirements, and provide the flexibility required to successfully structure the transaction, funding will need to provide sustainable long-term revenue streams. These revenue streams need to be effectively ring-fenced (e.g. via an SPV structure) from the debt constraints (and credit ratings) of the local government, as do the associated risks. This is both to ensure the alternative financing structure is a stand-alone financially viable/robust project and to alleviate the relevant Council's financial constraints. These constraints are particularly biting for councils working to address the challenges associated with accommodating rapidly growing populations. Ring-fencing of revenue and risks is the key to alternative financing models successfully addressing the borrowing constraints faced by the sector, transactions need to be structured to achieve off-council balance sheet treatment (from a rating agency perspective).

6.3.2. Simple and Transparent

If a new suite of funding tools is to gain political acceptance and, therefore, realistically be able to be implemented, they will need to be easily understood and highly transparent. It will need to be entirely clear to those who are paying exactly what they are funding, why, and on what basis (i.e. as close to user-pays as possible). Similarly, what is being delivered as a result of the investment will need to be distinct, definable and easily communicated.

Related to this, new revenue tools will need to be simple enough to provide the flexibility necessary for them to be adapted to the specific requirements of different projects or circumstances. Complex, difficult to understand or rigid funding tools are unlikely to successfully advance the policy objectives behind the inquiry.

To avoid issues of inequity, funding mechanisms will need to avoid potential "double taxation". By design, the beneficiaries of infrastructure asset and/or services resulting from alternative financing models will be those providing the funding. However, those making payments will also be, or will become, general ratepayers. Where the infrastructure services provided by the new financing model is normally funded through general rates, there is a risk that the new funding tool will result in those on whom it is levied paying twice for the service (i.e. a general contribution and a specific levy). To avoid this, new funding tools will need fit for purpose mechanisms for targeted rates relief.

6.3.3. Clarity of Revenue and Returns

In our experience, if funding tools are to deliver outcomes consistent with commercial constraints and imperatives, they will need to generate clear project-specific revenue streams, which in turn translate into sustainable risk-adjusted returns. To successfully facilitate new and innovative commercially-driven financing models, the underlying funding sources/mechanisms need explicit linkages between risk and return in their design. The concept of investment being analysed on the basis of returns compensating for allocated risk is central to commercial investment decision making, but is not a principle that is necessarily at the forefront of public sector capital investment decision-making.

6.3.4. Clear Risk Allocation

Related to above, if new funding tools are to be attractive from a commercial perspective, they will need to enable risks to be clearly identified, effectively allocated between the relevant investment partners/parties and appropriately remunerated. Projects will need to provide for sufficient risk, and return, to be transferred to the investment partner requiring commercial returns.

6.3.5. Cash Flow Flexibility

Traditional public sector funding mechanisms tend to deliver an annuity style revenue stream (typically adjusted for some proxy variable capturing growth). The resulting smooth revenue profile will, however, almost invariably not fit the actual cash flow requirements necessary to make the financing models discussed in this paper work. Such models tend to involve different funding requirements at the various stages of their development and operations.

To be commercially attractive to the most potential investors, new funding tools would preferably create a revenue stream which can be adjusted to fit with potentially lumpy cash flow requirements. Achieving this is likely to involve some policy challenges as it is different from the approach that has traditionally been applied in public sector funding. However, given the Fund's long-term investment horizon and lack of liquidity constraints, as long as the overall risk adjusted rate of return is viable, we believe we are in a unique position to offer potential investment solutions for projects where returns are not necessarily matched to cash flow requirements.

7. Next Steps

We welcome this inquiry and see it as taking a fresh approach to the serious and far reaching problems facing the New Zealand local government sector. In our submission, we have set out the areas in which we believe the Fund can make a contribution, our partnership framework for investing in large domestic projects, examples of alternative financing models that could be used to deliver these projects, and the issues and factors that will need to be addressed for them to be realistically achieved. To build on the framework and investment principles set out in our submission, we would welcome the opportunity to engage further with the Commission to develop alternative financing models and the revenue tools necessary to deliver feasible investment opportunities.