



COVERSHEET

Minister	Hon Shane Jones	Portfolio	Regional Development
Title of Cabinet paper	Using Provincial Growth Fund (PGF) underspends to address cost pressures for two PGF projects	Date to be published	7 June 2024

List of documents that have been proactively released

Date	Title	Author
April 2024	Using Provincial Growth Fund (PGF) underspends to address cost pressures for two PGF projects	Office of the Minister for Regional Development
9 April 2024	Using Provincial Growth Fund (PGF) Underspends to Address Cost Pressures for Two Projects EXP-24-MIN-0021 Minute	Cabinet Office

Information redacted

YES / NO

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Some information has been withheld for the reasons of Confidential advice to Government and Commercial information.

In Confidence

Office of the Minister for Regional Development

Cabinet Economic Policy Committee

Using Provincial Growth Fund (PGF) underspends to address cost pressures for two PGF projects

Proposal

- 1 This paper seeks Cabinet approval to reprioritise Provincial Growth Fund (PGF) underspends to provide up to:
 - 1.1 \$5.000 million in additional PGF loan funding to cover cost pressures for the Northland Water Storage and Use – Kaipara Water Infrastructure project.
 - 1.2 \$5.000 million in additional PGF grant funding to cover cost pressures for the Government Garden Cultural Quarter (Rotorua Museum) project
- 2 Cabinet's decision is required as, if approved, the total funding for each of the projects will exceed the \$20.000 million threshold over which PGF investment decisions must be made by Cabinet [CAB-18-MIN-0045].

Relation to government priorities

- 3 The PGF reprioritisation process aligns with ongoing decision-making principles of our coalition Government as it is fiscally-responsible fiscally neutral and has no impact on fiscal indicators.
- 4 This is a routine operational adjustment that requires Cabinet approval.

Background

- 5 In 2017, the Government established the PGF – a \$3.000 billion investment fund designed to ensure regional New Zealand thrives through economic growth [CAB-17-MIN-0054].
- 6 Cabinet agreed that a group of Ministers would have the delegated authority to make funding decisions between \$1.000 million and \$20.000 million per project, and that proposals over \$20.000 million would be approved by Cabinet [CAB-18-MIN-0045].
- 7 PGF projects can have underspends (lower costs, reductions in scope or projects not proceeding) and overspends (cost increases, unforeseen costs or delays due to weather events). Cabinet delegated the authority to the Minister of Finance and the Minister for Regional Development to make decisions on the use of future funding made available from funds managed by Kānoa –

Regional Economic Development & Investment Unit (Kānoa – RDU)¹ [CAB-21-MIN-0520], including the PGF. As a result, the Minister of Finance and the Minister for Regional Development undertake a PGF reprioritisation process to make decisions on the allocation of surplus PGF funding in order to manage project cost pressures².

- 8 Given the timing of the PGF, a number of projects have been impacted by unforeseen cost increases arising from the COVID-19 pandemic, global supply chain disruptions, weather events, and inflationary pressures. The reprioritisation process of surplus PGF funding is fiscally neutral and is critical to the viability of the PGF project portfolio.
- 9 The reprioritisation process has been undertaken 10 times and resulted in the reprioritisation of \$171.322 million of surplus funding being reprioritised, including to the Regional Strategic Partnership Fund. Specifically for projects experiencing cost pressures, \$52.71 million has been reprioritised for 30 projects.
- 10 The most recent PGF reprioritisation process has identified Confidential advice to Government in PGF surplus funding available to manage project cost pressures. Kānoa – RDU officials are expected to provide advice to the Minister of Finance and the Minister for Regional Development on the next reprioritisation round by the end of March 2023.

Cost pressure criteria

- 11 The PGF reprioritisation process uses cost pressure criteria to support Ministers' decision making. Projects are assessed as to whether:
 - 11.1 there are no alternative funding sources available to the recipient prior to seeking additional Crown funding
 - 11.2 the recipient has shown evidence of project costs, that all reasonable efforts have been made to make project delivery as efficient as possible, and the costs as low as practicable
 - 11.3 the benefits of the project have either been realised partly, or will be demonstrably and evidentially realised by the completion of the project
 - 11.4 without additional funding the completion of the project is at significant risk.

An additional \$5.000 million is required for the Northland Water Storage and Use – Kaipara Water Infrastructure project to address cost pressures

- 12 Te Tai Tokerau Water Trust (the Trust), has received a total of \$18.500 million in PGF loan funding for the pre-construction development, detailed design, construction and operation of water storage and reticulation infrastructure in

¹ A unit within the Ministry of Business, Innovation and Employment that administered and continues to manage the investments of the PGF.

² This reprioritisation process has typically occurred on a twice-yearly basis in March and October.

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the Kaipara region. The project seeks to establish a 3.3 million cubic metre reservoir which will hold sufficient water to support approximately 1,100 hectares of new horticultural development.

- 13 The Trust was established following the approval of three Tai Tokerau water storage projects for funding through the PGF. The Trust is the developer of the projects.
- 14 Once complete, asset ownership will be transferred to Kaipara Water Company. Kaipara Water Company will own and operate the reservoir and associated infrastructure on behalf of all shareholders. Kaipara Water Company is currently owned by the Trust (59%) and seven entities that have purchased water shares from the Trust (41%). Future water share purchasers will have ownership transferred to them from Kaipara Water Company in proportion to water shares purchased.
- 15 The project is expected to have a range of key benefits including:
 - 15.1 economic development through enabling growth in the agricultural sector and the development of alternative sustainable land uses
 - 15.2 increasing the productivity of whenua Māori, by enabling horticultural developments
 - 15.3 environmental improvements and sustainability (including climate adaptability).
- 16 In June 2020, an \$18.500 million loan through the PGF was approved for the project, including:
 - 16.1 up to \$7.000 million as a suspensory loan³ for pre-construction activities and land acquisition
 - 16.2 up to \$11.500 million as a loan for construction.
- 17 The project is now in the final phase of its multi-year construction process, with an estimated five months of construction remaining until completion.
- 18 As part of the December 2023 reprioritisation round, the Minister of Finance and I agreed to provide an additional \$5.000 million loan for this project. This was based on an incorrect figure for the total project funding approved, supplied by Kānoa – RDU officials, showing total funding for this project did not exceed \$20 million and was appropriate for Joint Ministers decision.
- 19 I subsequently announced the additional funding for this project on 2 February 2024.
- 20 As of 6 March 2023, none of the additional \$5.000 million has been paid to the Trust.

³ A suspensory loan was approved as, if the pre-construction work was not successful in establishing the consenting and contractual environment for the construction phase, it provided a contractual provision to suspend loan repayment obligations.

- 21 Officials have now provided a corrected figure for the total project funding approved to date (as outlined in paragraph 15) and advised that the additional \$5.000 million loan will need to be considered by Cabinet as per the delegated authority [CAB-18-MIN-0045].
- 22 A table summarising key project information, including finance shares, ownership details, and estimated completion dates is included in Appendix 1.

Project delays have caused cost pressures

- 23 Cashflow challenges have been experienced due to project delays. Specifically, the construction schedule was significantly delayed by COVID-19 lockdowns preventing contractors from getting onto site, and an extended period of wet weather during the summer of 2022-23 (including Cyclone Gabrielle) compromised ground conditions and slowed construction considerably, with unusually windy conditions slowing the installation of the reservoir liner. As a result, the cost of the project has increased to Commercial Information.

- 24 Commercial Information

- 25 An additional \$5.000 million loan is required to complete the project.

- 26 Commercial Information

- 27 Kānoa – RDU has advised that the project meets all cost pressure criteria. A summary of this assessment is provided in Appendix 2.

I recommend cost pressures are met through Provincial Growth Fund surpluses

- 28 If the additional funding requirement is unable to be met, this project will be unable to pay contractors and related creditors for March services and works when invoices fall due on 20 April 2023, compromising the Trust’s ability to work with contractors on this and other projects. If the project is unable to be completed, this will compromise water supply to businesses that have purchased the right to access water from the project and made subsequent business investment decisions, and result in unusable, partially completed water infrastructure.

- 29 Te Uri o Hau Avocado Orchard Development, which received \$1.740 million in loan funding through the Regional Strategic Partnership Fund to establish an avocado orchard near Te Kōpuru, Northland, has purchased shares to access water from the project. Without access to water, the viability of this project will be significantly compromised.
- 30 I seek your approval to provide up to an additional \$5.000 million in PGF funding to the Trust in the form of a loan to cover cost pressures, taking total approved funding to \$23.500 million.
- 31 Loan financing is recommended for additional funding. Equity financing is not suitable as purchasing shares in the Kaipara Water Company is not an option because the Crown has no use for the water rights that ownership confers. Equity financing would also commit the Crown to meeting annual reservoir operation charges.

Project risks and impact of not funding cost pressure

- 32 Given the project's nearness to completion, there are limited risks to overall project viability or deliverability if the cost pressure funding is approved. The project has confirmed customers who have already paid for water rights.
- 33 If the cost pressure funding was not approved, the Trust would likely suspend construction until capital raising conditions improve. However, the incomplete state of the project would mean that capital raising through water share sales would be compromised.
- 34 The advanced stage of construction means that the Trust has drawn down both pre-construction and construction loan facilities, as such there would be no funding available to be returned if the cost pressure was not approved.

An additional \$5.000 million is required for the Government Garden Cultural Quarter (Rotorua Museum) project to address cost pressures

- 35 Rotorua Museum is in the Government Gardens within the Category 1 heritage Bath House building which opened in 1908. The museum was identified as earthquake prone and closed to the public in 2016 following the 7.8 magnitude Kaikoura earthquake.
- 36 The museum, which includes the Bath House, is a significant heritage building⁴ in Rotorua and previously brought economic benefit to the region and is a major feature of the Government Gardens on the lake's edge of downtown Rotorua alongside the Polynesian Spa and the Arts Village.
- 37 In 2019 Rotorua Lakes Council (RLC), which operates the museum, obtained \$20.000 million of Government funding towards the \$55.500 million remediation and reopening of the museum. This funding comprised \$15.000 million from the PGF, and \$5.000 million from the Regional Culture and Heritage Fund administered by the Ministry of Culture and Heritage.

⁴ The Rotorua Museum is a Heritage New Zealand Category One Building, which recognises it as having special or outstanding historical or cultural significance.

Rotorua Lakes Council contributed \$15.500 million, alongside other co-funding commitments from various non-Governmental parties.

- 38 In addition to ensuring that museum building was restored and met at least 80 per cent of the National Building Standards, the remediation and reopening of the Rotorua Museum was expected to have a range of key benefits including:
- 38.1 enabling the integration of the museum with the Energy Events Centre and Sportsdrome to provide one of the largest conferencing and cultural centres in the Central North Island
 - 38.2 attracting more events to the Cultural Quarter which connects to the Rotorua Lakefront and Whakarewarewa Forest developments
 - 38.3 generating higher yield tourism benefits to improve economic and social outcomes in Rotorua.
- 39 Some work has commenced on the project including the removal of all exhibitions, most of the strengthening and asbestos removal work required for the south wing and basement, investigations for geotechnical, structural, architectural, and other services as well as resource, historical and building consent processes. To fund these works, \$10.000 million of approved PGF funding has been drawn down, and approximately \$5.300 million used.
- 40 Since work commenced, a total of \$17.000 million in PGF grant funding has been approved for the Government Garden Cultural Quarter (Rotorua Museum):
- 40.1 In June 2019, a \$15.000 million grant was approved to RLC toward the remediation and upgrade of the Rotorua Museum which had a total expected project cost of \$50.000 million.
 - 40.2 In June 2020, additional grant funding of \$2.000 million was approved for the project as a result of a scope change to enable the replacement (rather than repair) of the roof.


Project delays have caused cost pressures

- 41 The cost to complete the project (estimated at \$55.500 million at the time of approval) has now increased significantly to \$73.600 million. Officials note that RLC has worked with the tendered to negotiate the original estimate down to the current figure.
- 42 In light of project cost increases, Rotorua Lakes Council (RLC) voted to continue the project but keep its funding contribution at \$15.500 million. This was due to a number of other cost pressures RLC has related to critical infrastructure. RLC instead worked to secure additional funding from other sources, including an additional \$4.000 million from the Ministry for Culture and Heritage (MCH) (which takes MCH's contribution to the project to \$9.000 million), \$5.000 million from the Rotorua Trust (formerly Rotorua Energy

Charitable Trust) and \$4.100 million from the Bay of Plenty Regional Council, via the Centennial Trust.

- 43 RLC is now seeking a \$5.000 million increase in total grant funding for the project to address cost pressures. RLC is unwilling to take on additional debt for the project, as such loan funding from the PGF is not a viable option.
- 44 RLC's maximum debt to revenue ratio is set at 250 per cent as at June 2023, just below the legal debt ceiling of 280 per cent. RLC have a net debt of \$343 million as at 30 June 2023, around 205 per cent of its debt to revenue ratio.
- 45 Kānoa – RDU has advised that the project meets all cost pressure criteria. A summary of this assessment is provided in Appendix 2.

I recommend cost pressures are met through Provincial Growth Fund surpluses

- 46 RLC has undertaken a tender process and are currently negotiating with the preferred contractor, where they are looking to secure a contract to undertake the works for \$73.600 million. This price is due to expire on 12 April 2024, at which a tender process will need to be conducted again and it is expected that any tendered price for the project will be significantly higher due to rising construction costs.
- 47 The fixed price tender of \$73.600 million was originally set to close on 1 March 2024, which was 90 days from the close of tender. In waiting for decisions on additional funding, RLC requested an extension to 27 March 2024 and then again to 12 April 2024. Should the tendered price expire, the estimated cost escalation from a further extension or from re-tendering is expected to be at least Commercial Information.
- 48 If the additional funding requirement is unable to be met during the current tender process, it is highly likely the project will not proceed as RLC believes it has exhausted all other avenues of funding. This would likely result in the permanent closure of the building and the anticipated benefits of the project not being realised.
- 49 Kānoa – RDU officials have advised that they intend to negotiate the funding agreement including conditions and funding milestones to manage the risks to this funding. Commercial Information

- 50 I seek your approval to provide up to an additional \$5.000 million in PGF grant funding to Rotorua Lakes Council to cover cost pressures for the project, taking total approved funding from the PGF to \$22.000 million.

Project risks and impact of not funding cost pressure

- 51 The historic nature of the building means there is a significant risk of unforeseen costs and cost overruns once construction begins. As such, I recommend that, if agreed, the funding be conditional that

Commercial
Information

- 52 If Cabinet does not agree to provide the cost pressure funding for this project and it is unable to proceed, Kānoa – RDU will seek the return of \$8.000 million of the \$10.000 million in funding that has been drawn down for progress to date. A portion of the funding, \$2.000 million, is unlikely to be sought as it reflects a share of costs incurred to date. In total, \$15.000 million of the approved \$17.000 million of funding could be returned and made available for future cost pressures in other PGF projects as per the agreed process [CAB-21-MIN-0520].

Financial Implications

- 53 The PGF reprioritisation process is fiscally neutral and has no impact on fiscal indicators. The process has been undertaken 10 times and resulted in the reprioritisation of \$171.322 million of surplus funding.
- 54 There is Confidential advice to Government of PGF surplus funding available for reprioritisation to projects experiencing cost pressures.

Legislative Implications

- 55 These proposals have no legislative implications.

Impact Analysis

- 56 These proposals have no regulatory, climate, or human rights impacts.

Population Implications

Northland Water Storage and Use – Kaipara Water Infrastructure

- 57 The Te Uri o Hau Avocado Orchard Development, which has purchased water shares in the project is being undertaken by the commercial arm of Te Uri o Hau Settlement Trust, a hapu of Ngāti Whātua whose area of interest is in the Northern Kaipara region. The project is a key way in which Te Uri o Hau Settlement Trust is seeking to realise hapu aspirations and improve social and commercial outcomes for their people.

Government Garden Cultural Quarter (Rotorua Museum)

- 58 In 2023 Rotorua Lakes Council undertook community consultation again to check if the community wanted to project to proceed and reconfirm the Council contribution. Community feedback was 85 per cent in support to proceed with the project and limit the Council's contribution to \$15.500 million

59 The land on which the Rotorua Museum sits was gifted by local iwi, Ngāti Whakauwe, in 1876 with the building being constructed between 1906 and 1908. Heritage New Zealand recognises the buildings' cultural significance as a manifestation of the land gifted by Ngāti Whakauwe and the role it has had housing taonga of importance to Te Arawa.

Use of External Resources

60 No external resources have been used in the development of this proposal.

Consultation

61 The Treasury and the Ministry for Culture and Heritage have been consulted on this proposal.

Proactive Release

62 This paper will be proactively released within 30 days of announcement.

Recommendations

The Minister for Regional Development recommends that the Committee:

63 **note** on 13 December 2021, Cabinet delegated to the Minister of Finance and Minister for Regional Development the authority to make decisions on the use of future funding made available from funds managed by Kānoa – Regional Economic Development & Investment Unit (Kānoa – RDU), including the Provincial Growth Fund (PGF) [CAB-21-MIN-0520];

64 **note** Kānoa – RDU has identified two existing PGF projects that require up to \$5.000 million each due to cost pressures, and that these two projects' cost pressures could be funded by Confidential advice to Government in PGF surplus funding;

65 **note** Cabinet's approval is sought as, if approved, funding for both the projects will exceed the \$20.000 million threshold over which PGF investment decisions must be made by Cabinet [CAB-18-MIN-0045];

66 **note** the two project cost pressures are:

66.1 Northland Water Storage and Use (Kaipara Water Infrastructure) – seeking up to \$5.000 million in PGF loan funding to complete the final five months of the multi-year construction project;

66.2 Government Garden Cultural Quarter (Rotorua Museum) – seeking up to \$5.000 million in PGF grant funding as a result of increased project cost estimates to enable construction to begin;

67 **note** Kānoa – RDU have assessed both projects against the cost pressure criteria and advised that all criteria are met;

68 **note** funding for the Kaipara Water Infrastructure project has already been announced as the Minister of Finance and the Minister for Regional

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Development agreed to provide an additional \$5.000 million loan for this project in December 2023, based on an incorrect figure for the total project funding approved, supplied by Kānoa – RDU officials.

- 69 **note** officials have now provided at corrected figure for the total project funding approved to date and advised that the additional \$5.000 million loan will need to be considered by Cabinet as per the delegated authority [CAB-18-MIN-0045].
- 70 **note** no additional funding has been paid for the Kaipara Water Infrastructure project to date.
- 71 **agree** to provide up to an additional \$5.000 million in PGF loan funding to Te Tai Tokerau Water Trust for the Northland Water Storage (Kaipara Water Infrastructure) project to address its cost pressures.
- 72 **agree** to provide up to an additional \$5.000 million in PGF grant funding to Rotorua Lakes Council for the Government Garden Cultural Quarter (Rotorua Museum) project to address its cost pressures.

Authorised for lodgement

Hon Shane Jones

Minister for Regional Development

Appendix One: Project summary tables

Northland Water Storage – Kaipara Water Infrastructure project

Project and brief description	<i>Northland Water Storage and Use – Kaipara Water Infrastructure project</i> The project aims to undertake a water and irrigation project in the Kaipara District. It would establish a reservoir for use by nearby horticultural developments. It is one of three water projects funded through the PGF in the region to increase water security for the Te Tai Tokerau region.
Initial project cost (before cost escalation)	\$18.5 million
Finance share of total costs per partner	Provincial Growth Fund - \$18.5 million (100%) (\$7.0 million suspensory loan + \$11.5 million loan)
Ownership arrangements	Te Tai Tokerau Water Trust – 100% ownership
Initial completion date	Estimated five months until completion
Project costs escalation	Commercial Information
Financing of project cost escalations	Northland Regional Council - Commercial Information Water share entitlement payments - Commercial Information (seeking) Provincial Growth Fund - \$5.0 million (69.4%)

Government Gardens Cultural Quarter (Rotorua Museum) project

Project and brief description	<i>Government Gardens Cultural Quarter (Rotorua Museum)</i> The project is to reopen the Rotorua Museum after its closure as an earthquake-prone building. It is a Category One listed historical building and remediation would re-establish one of the North Island's larger conferencing and cultural centres and generate higher yield tourism benefits.
Initial project cost (before cost escalation)	\$55.5 million
Finance share of total costs per partner	Provincial Growth Fund- \$17.0 million (30.6%) Rotorua District Council - \$15.5 million (27.9%) Rotorua Energy Charitable Trust - \$10.0 million (18%) Lotteries Significant Projects - \$6.0 million (10.8%) Ministry of Culture and Heritage - \$5.0 million (9%) J Lagouw - \$1.0 million (1.8%) New Zealand Community Trust - \$0.60 million (1.1%) Lotteries Heritage - \$0.35 million (0.6%)
Ownership arrangements	Rotorua District Council – 100% ownership
Expected completion date	Within two years
Project costs escalation	Increased to \$73.6 million (\$18.1 million increase)
Financing of project cost escalations	Ministry of Culture and Heritage - \$4.0 million (22.1%) Rotorua Energy Charitable Trust - \$5.0 million (27.6%) Bay of Plenty Regional Council - \$4.1 million (22.7%) (seeking) Provincial Growth Fund - \$5.0 million (27.6%)

Appendix Two: Cost pressure assessments

Northland Water Storage and Use – Kaipara Water Infrastructure

Criteria	Assessment against criteria
<p><i>There are no alternative funding sources available to the recipient prior to seeking additional Crown funding</i></p>	<p>✓ Te Tai Tokerau Water Trust (the Trust) has explored options to raise funds elsewhere. No alternative funding source is available, and the Trust is not in a position to fund any cost overruns.</p> <p>Potential water share purchasers have been engaged, but the investment environment has meant that commitment has not been secured to date.</p> <p>Commercial Information</p>
<p><i>The recipient has shown evidence of project costs, and that all reasonable efforts have been made to make the project delivery as efficient as possible and the costs as low as practicable</i></p>	<p>✓ The project is in the final phase of a multi-year construction process, and opportunity to reduce scope is limited. The recipient has reduced costs elsewhere where feasible by reducing spend on a water piping network.</p>
<p><i>Benefits of the project have either been realised partially or will be demonstrably and evidentially realised by the completion of the project</i></p>	<p>✓ The project is approximately five months from construction completion. Projects that will be served by this project have commenced, and their viability is reliant on access to water.</p>
<p><i>Without funding the completion of the project is at significant risk.</i></p>	<p>✓ Without funding, the reservoir will not be completed and water supply to those who have purchased water shares will most likely be compromised (including a project funded through the Regional Strategic Partnership Fund – Te Uri o Hau Avocado Orchard Development).</p>

Government Garden Cultural Quarter (Rotorua Museum)

Criteria	Assessment against criteria
<i>There are no alternative funding sources available to the recipient prior to seeking additional Crown funding</i>	<p>✓ Rotorua Lakes Council (RLC) have secured \$5.600 million in additional funds from other sources, including an additional commitment of \$4.000 million from the Ministry for Culture and Heritage. There are no further sources of funding available; RLC have elected not to increase their direct contribution of \$15.500 million.</p>
<i>The recipient has shown evidence of project costs, and that all reasonable efforts have been made to make the project delivery as efficient as possible and the costs as low as practicable</i>	<p>✓ Funds will be used for capital items in line with the original approval. Due to delays beginning the project, costs have now increased significantly (from an estimated \$50.000 million on approval to \$73.600 million).</p> <p>Engineers have made changes to the design of the project to bring down the additional costs required as much as possible. In addition, RLC has worked with the tenderer to negotiate the price of the contract down.</p>
<i>Benefits of the project have either been realised partially or will be demonstrably and evidentially realised by the completion of the project</i>	<p>✓ As the Rotorua Museum remains closed, no benefits of the project have been realised. The benefits will not be realised until project completion.</p>
<i>Without funding the completion of the project is at significant risk.</i>	<p>✓ Without additional funding, RLC is unable to accept a quoted sum of \$73.600 million for the project which has been tendered by a contractor. The quote is due to expire in early-April, however a further extension has been requested. If this quote lapses, it is expected that further quotes will be significantly higher and may result in the project not proceeding.</p> <p>The building is unlikely to be able to be remediated and will need to be demolished.</p>