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PROVINCIAL DEVELOPMENT UNIT

Investment Statement
for the Provincial Growth Fund

Contents

The Provincial Growth Fund

The Provincial Growth Fund (PGF) is a $1 billion per annum commitment for three years to support regional economic development.

The performance of the regions matters for people who live in the regions and for the country as a whole.

Our major export earners - primary industries and tourism - are located largely in the regions, with complementary inputs (such as head office, professional services, R&D, capital markets) that are typically located in the main urban centres (with deeper labour markets and the advantages of physical proximity).

Employment and income levels vary significantly across the regions, as well as within each region. Differences in regional performance, particularly in relation to population growth, have persisted over recent years, with some regions performing strongly while others have done less well.

People in regions that are struggling economically are at risk of poorer social outcomes.

Global trends such as globalisation, climate change, urbanisation, automation and ageing may, absent action, accelerate the rate of relative decline for some of New Zealand's provincial towns and regions.

PGF objectives

The primary objective of PGF is to accelerate regional development through increasing the productivity potential of and contributing to more and better-paid jobs in the regions.

PGF has five supporting objectives.

Jobs and sustainable economic development: investments support increased jobs (with a focus on high quality jobs) and sustainable economic development over the long term, particularly in regions and sub-regions where unemployment is high and there are significant social challenges;

Social inclusion and participation: investments support increased social inclusion through effective training, work preparation and support that enables more people to fully participate in work and society;

Māori development: investments enable Māori to realise their aspirations through greater participation in all aspects of the economy;

Climate change and environmental sustainability: investments support opportunities to achieve New Zealand's climate change commitments and encourage more sustainable and productive use of land, water and other resources; and

Resilience: investments increase regional and national resilience by improving critical infrastructure and focusing on opportunities to grow and diversify our economy.

PGF and building a productive, sustainable and inclusive economy

Government is committed to building an economy that is productive, sustainable and inclusive.

PGF will contribute to this goal by lifting the productive potential of the regions and helping to ensure that all New Zealanders, regardless of where they live, are increasingly able to share in this prosperity.

Challenges and opportunities

Over recent years, New Zealand has achieved stronger economic growth than most other developed economies. At the national level, labour market participation remains high and unemployment is low by historical standards.

While this economic growth has delivered a range of benefits, there have also been adverse impacts, the addressing of some of which is central to the opportunity presented by PGF.

The growth has been driven to a significant extent by population increases and in areas of relatively low productivity and low wages (notably building and construction).

The geographic concentration of the population growth has put considerable pressure on infrastructure and housing in Auckland and, to a lesser absolute extent, in places such as Tauranga and Queenstown. A number of other regions have seen relatively static populations that are gradually ageing.

Despite the low national unemployment, pockets of above-average unemployment and of people not in employment, education or training (NEETs) have persisted, notably in parts of the PGF surge regions.

At the same time, employers have expressed concern about ongoing labour shortages in a range of job-types.

A significant proportion of jobs are at or close to minimum wage, are part-time, often with uncertain hours, and offer little in the way of professional development opportunities.

Productivity remains relatively low in comparison with other small, developed economies, in part because of a relatively low level of capital investment per member of the workforce.

Growth in population and in some forms of economic activity has put considerable pressure on our natural environment.

Transitions

To achieve the goal of a productive, sustainable and inclusive economy, while responding to the opportunities and challenges of climate change and ongoing technology development will require 'just' transitions. This means workers, businesses and central and local government co-creating responses to these challenges and opportunities.

Government will set important elements of the context within which these transitions occur. This will require an aligning of all of government's various levers of influence, including through:

- A well-designed, effectively-enforced and stable set of environmental policies, regulations and institutions that:

  - Set appropriate standards for environmental performance
  - Incentivise innovation by ensuring where practicable that businesses impacting on the environment face costs that they impose.
  - Deal effectively with dispersed and cumulative environmental impacts
  - Chart a stable and predictable path to a low emissions economy by 2050.
- A business environment that:
  - Incentivises businesses to invest, innovate and compete in productive activities that will maximise economic value-add
  - Is supported by government investment in science, tertiary education, infrastructure, market access and in-market support to build-out from well-established strengths
  - Makes the most of New Zealand's relatively small size, trust-based relationships and agility in seizing opportunities (such as in space and satellite-launching: business-led and government-enabled)
- Labour market, education, skills, training and immigration systems that:
  - Offer increasing opportunities for higher quality employment, in terms of both pay and conditions, for all New Zealanders
  - Pro-actively support New Zealanders to acquire new capabilities throughout their working lives as they adjust to the impact of ongoing change, led by the individual but with active support from government, employers and worker representatives
  - Ensure that immigration clearly contributes to a higher productivity/higher wage economy (while also fulfilling New Zealand's human rights' responsibilities)
  - Incentivises employer groups to invest in the training and development of their people and to avoid undue reliance on migrant labour.

Transitions and regional economic development

For the regions, this translates into three main opportunities that are priorities for PGF:

- To invest in strengthening the eco-systems (such as skills, knowledge, networks) and supporting infrastructure that underpin current and future areas of economic opportunity in the regions, enabling accelerated business growth and increased average wages and improved career prospects
- To invest in the innovation and improved business practices that will reduce the environmental impact of land-based economic activity in the regions, and support the transition to a net-zero-carbon economy.
- To better support people to take advantage of new opportunities through employment, particularly in towns and sub-regions where the proportion of NEETs has been persistently high

Progress in these three areas will:

- Raise the productivity potential of the regions
- Support improved economic outcomes for Māori
- Help ensure that future population growth is more likely to be more evenly distributed than of late, which would enhance national economic resilience, reduce pressure on infrastructure and housing in Auckland and ensure continued effective utilisation of infrastructure across the rest of the country
- Enhance the attractiveness of the regions as places in which to live, play, work and do business, to the benefit of all New Zealanders.

Scope of PGF

The PGF has three inter-related tiers of investment:

1. Regional projects, capability-building and feasibility studies
2. Sectors, including One Billion Trees
3. Infrastructure

The geographic coverage of the Fund is regional New Zealand.

The major urban centres - Auckland, Christchurch and Wellington - are excluded. The balance of Canterbury is included, as is Kapiti Coast in the Wellington region.

Six ‘surge’ regions have been prioritised: Te Tairāwhiti/East Coast, Hawke’s Bay, Tai Tokerau/Northland, Bay of Plenty, West Coast and Manawatu-Whanganui.

In each region - surge and otherwise - there are towns and sub-regions that are less affluent than is the region as a whole. The Fund is particularly targeted to plans and proposals aimed at supporting investment and employment in these areas, rather than in the larger provincial cities (while recognising the connections within regional economies).

Māori are strongly represented in the surge regions.

Infrastructure priorities for PGF are transport and telecommunications, both of which are essential underpinnings for economic development.

Local government-owned water infrastructure, large-scale irrigation projects, social infrastructure (such as hospitals and schools) and Kiwibuild are all out-of-scope.

The Fund is open to a wide range of entities, including central and local government, State Owned Enterprises, Māori organisations, iwi and related authorities, and commercial enterprises and philanthropists.

Three tiers of PGF investment

PGF has three tiers of investment:

Tier 1: Regional proposals, capability building and feasibility studies

Tier 2: Sectors

Tier 3: Infrastructure

These tiers are inter-related. For example, a sector investment might include an element of capability building and might also require a related investment in transport infrastructure.

This structure for the Fund enables a combining of regionally-led proposals with initiatives that can benefit multiple regions and achieve economies of scale in procurement and execution.

Investment proposals can originate from a regional, capability, sectoral or infrastructural perspective, but the benefits delivered must be focused on the regions, and contribute to the achievement of PGF objectives.

PGF Investment Tier 1: regional proposals, capability building and feasibility studies

Regional priorities, action plans and proposals

Every community wants a sense that they are in control of their own destiny, and that support will be there when they need it.

Effective regional leadership and active engagement by communities, Māori and business is essential if regions are to prosper over the long-term, and to adapt successfully to ongoing change and transition.

Over recent years, regional leaders, with support from central government, have undertaken regional studies to better understand their region's opportunities for and barriers to growth, and used these as the basis for developing prioritised action plans.

PGF welcomes this approach. The development of regional action plans has provided a strong reason for regional leaders and groups to work collaboratively, to take a region-wide view of development, to prioritise scarce resources and to pursue regional proposals that are coherent and mutually reinforcing (e.g. linking proposals for economic activity with related proposals for capability-building and for enhancements to transport infrastructure).

Updating regional economic development action plans

The current set of regional action plans was developed when central government's dedicated financial contribution (through the Regional Growth Initiative) was around $11 million per annum compared to the PGF at $1 billion, for each of the next three years.

PGU will support regional leaders who choose to update their plans to reflect this change, and to ensure that the plans have the right level of ambition to match the available resources.

Plan refreshes should be short and sharp, building on the analysis, knowledge and relationships developed in the preparation of the existing plans.

Regional leaders are encouraged to prioritise one or two areas of economic activity in which the region has both strengths and opportunity.

PDU will support regional leaders to identify connections across regions, that enable leveraging of initiatives in one region to the benefit of another, and to avoid investment in proposals that have the potential to advantage one region at the expense of another.

Status of PGF proposals in relation to regional action plans

Applicants submitting proposals to PGF without reference to the relevant regional action plan(s) would reduce incentives to participate in collaborative cross-regional processes; the coherence of regional plans and the prioritisation of investment proposals could be compromised.

At the same time, there is merit in retaining flexibility in the operation of the Fund - some opportunities will come up at short-notice, others might result from cross-regional initiatives, and so would not originate from regional planning processes.

PGF has a strong expectation that region-specific proposals will form part of a region's agreed action plan, but this is not a strict pre-condition for PGF eligibility.

Apart from reasons of commercial confidentiality, all applicants should demonstrate that they have at least engaged with regional leaders, and reflected the latter's perspective in any proposal.

Allocating PGF investments across regions

Over the life of the Fund, the intention is to develop a portfolio of investments that is spread across all eligible regions, with an emphasis on the surge regions. In this sense, there is no 'first come first served.'

Regions that do not immediately make applications to the Fund will not miss out, subject to the constraint that the Fund will complete its investment commitments by 30 June 2020.

PDU will report regularly to IAP and to Ministers on funds allocated, including by region.

Supporting regions in their engagement with PGF

Quality regional action plans, integration with comprehensive infrastructure/transport planning and targeted investment proposals are important elements in ensuring that PGF investments deliver maximum value for the regions.

A risk associated with this approach is that the best-resourced regions may produce the best quality business cases, which could lead to an outcome that is not consistent with the PGF's objectives.

PDU and IAP will work actively with local government (including economic development agencies), Māori, business and community groups around the country, but particularly with the surge regions, to support the development of good ideas and strong investment proposals.

Capability development

People

Investment in the development of the people in our regions is an enabler of better economic and social outcomes, notably through increased employment and improved career prospects.

The PGF is most likely to add value over and above government's core post-schooling investment in people through Votes Tertiary Education and Social Development in areas that are priorities for the Fund and are employer-centric. Potential possibilities include:

- Scale-up the He Poutama Rangatahi programme to support communities to match rangatahi farthest from the labour market to local employment opportunities, through working with local employers and providing sustained pastoral care
- Work with sector leaders to accelerate the development of workforce plans to employ more local people in those regionally-based sectors that have become heavily reliant on migrant labour in recent years, including horticulture, viticulture, dairy and hospitality/tourism
- Support the building of digital capability in the regions, for local people and for local businesses, as part of an integrated approach to digital enablement of provincial communities and businesses (discussed further below)
- Forestry - to leverage the employment and career opportunities associated with the One Billion Trees programme.

PGF expects to co-invest in employer-specific initiatives e.g. where a business is proposing to invest in a surge region, and partners with PGF to support local people into employment via apprenticeships (or equivalent) that are co-funded.

PGF also invites proposals to trial innovative approaches to training and development, for example:

- Employer-led schemes in surge regions which, if successful, could then be integrated into the broader vocational education and training (VET) system (which is currently under review).
- Promoting support for and uptake of short courses (which could award microcredentials) in surge regions, as a means to support transitions for workers whose jobs have been or are expected to be impacted by technological or other change.

PDU will work with applicants and with government partners, notably TEC, MPI, MoE, MSD and TPK to ensure that PGF investments complement rather than replicate or substitute for other government-funded capability development initiatives.

Business

Effective local support for businesses, particularly start-ups, is an important element of regional economic development.

Central government provides a range of supports, including through the Regional Business Partners programme: government funded and administered by NZTE and Callaghan Innovation, but delivered locally, typically through one or both of the economic development agency and chambers of commerce.

Government also provides targeted support for incubators and for R&D (Callaghan Innovation), exporters (NZTE), farmers and growers and food and fibre industries (MPI) and Māori businesses (TPK).

The PGF will consider proposals that build on existing supports, and meet a clearly identified need or opportunity for enhanced business support that is specific to the PGF regions (including proposals that support more than one region) and priorities.

Feasibility studies

Feasibility studies are an important tool for testing the viability of business opportunities, particularly complex opportunities such as transport infrastructure investments. Funding of feasibility studies can be problematic for some parties.

PGF will consider contributing to the cost of feasibility studies, subject to confirming that the underlying investment proposal would contribute to achievement of PGF objectives, would credibly deliver public benefits in excess of public costs and has not previously been considered and declined by government (for reasons that remain relevant).

Feasibility studies will be grant-funded, and require much less in the way of process than larger investments.

PGF will consider the case for part-funding of proposals following completion of feasibility studies, and subject to their results.

PGF Investment Tier 2: Sectors

Tier 2 of the Provincial Growth Fund is sector-oriented investments, including the One Billion Trees programme.

PGF is open to investment proposals from all sectors and businesses.

The following paragraphs set out areas that PGF is prioritising, in support of national objectives, but on a non-exclusive basis.

A focus on exporting and the environment

Of the order of 70 per cent of the jobs in any region are focused on supplying the local population and the local economy. But for any region to prosper (and import those things that are not produced locally) it needs to produce goods and services that are traded with other regions and internationally.

Supporting investment through the PGF in internationally-traded sectors (subject to ensuring compliance with New Zealand's international obligations in relation to trade) is most likely to add value at the national as well as the regional level, because of: potential market size, opportunity to build economies of scale and lower likelihood of inter-regional competition for the same resources.

New Zealand businesses are of relatively small scale by international standards and, in our main exporting sectors, draw on national eco-systems for essential inputs (e.g. science and innovation, skilled labour, established supply chains, market access and connectedness and sector-specific infrastructure).

PGF investments represent a potential opportunity to further deepen and broaden these eco-systems, alongside ongoing government investment programmes (such as in science, tertiary education and infrastructure).

This is one way through which Fund investments will create enduring value beyond the specific proposals in which it co-invests.

New Zealand's export growth over the past ten years has been dominated by food and beverage, tourism and forestry - in which sectors New Zealand has demonstrated comparative advantage over a sustained period.

Within all three sectors, to varying degrees, increased volume (e.g. milk powder, unprocessed logs, low-spending tourists) and commodity price movements have been bigger drivers of growth than movements up the value chain.

Environmental considerations are a further reason to focus on these sectors. Growth in volume of food and beverage production and in international tourist numbers has put pressure on the natural environment in a variety of ways which, based on existing practices, are becoming increasingly unsustainable. To help address this, PGF provides an opportunity for communities and sectors to develop more sustainable and productive practices for the use of land and water.

Food and beverage, tourism and forestry are all sectors of importance to the surge regions (and feature in most regional action plans) and for Māori.

International demand in these sectors is widely projected to continue to grow, driven mainly by increasing affluence in the big Asian economies.

Food and beverage and the environment

All our regions have economic strengths in the primary sector, which still accounts for the majority of New Zealand’s exports. Challenges and opportunities for the primary sector are widely recognised, and include:

- Increasing the sustainable use of land and water
- Reducing the sector’s emission of greenhouse gases to support the transition to a low-carbon economy
- Adding value, through processing, improvements in on-farm/orchard practice and building brands that can earn market premiums
- The potential impact of further scientific progress in areas such as plant-based proteins

The PGF is an opportunity to realise additional value and to accelerate some of the transitions that we know lie ahead for our regions and for the primary sector, including through:

- Supporting higher-productivity and increased sustainability of land use such as by increasing the high-value use of collectively owned Māori land, and supporting land conversions to higher-value uses with lower environmental impacts (including food with scientifically-verified health attributes)
- The application of technology such as real-time sensors to optimise the use of fertiliser, and robotics to lower the cost and enhance the quality of primary sector products
- Co-investment in value-adding food and beverage production
- Programmes to address persistent areas of skill shortage, reduce reliance on migrant labour and support young people into employment

Access to water

One of the constraints to the increased sustainable use of land and water is access to a sufficiently reliable water supply. PGF will consider applications for small-scale irrigation (one or a few farms), that contribute to (non-dairy) higher-value land use (e.g. for Māori owned land) and improved environmental outcomes (e.g. water quality, biodiversity).

Forestry and One Billion Trees

Through the One Billion Trees programme the Government has signaled its intention to use forestry as a platform for building a sustainable and economically vibrant future for our provinces. It will support this by providing opportunities to create employment, optimise land use, mitigate climate change, protect the environment and ensure sustainable fibre has a key role in the future low carbon economy. The high-level goals for forestry include:

- achieving one vision for all New Zealanders in the One Billion Trees planting programme through comprehensive economic and civic engagement
- enabling Māori to achieve their forestry-related economic and cultural development aspirations

- supporting sector and regional productivity increases to capture full market value
- a strong, stable and reliable labour market which enables safe and rewarding lifetime careers in forestry
- better climate change and environmental outcomes, including for native ecosystems and habitats
- a stable investment environment enabling greater investment confidence in the forestry sector
- a stronger domestic market for wood products and security of supply for wood processors
- facilitating the transition to a low carbon economy through the replacement of petroleum-based products with wood-based products and the enablement of carbon farming

The role of forestry will be an important element in the development of regional economic development action plans and of regional land transport plans. Te Uru Rākau /MPI, NZTA and the PDU will work with regional groups to ensure a collaborative and integrated approach to planning and to the development of forestry-related investment proposals.

More information on the programme will be made available soon on the Te Uru Rākau /MPI website at www.mpi.govt.nz/teururakau.

Tourism and the visitor economy

Tourism and the visitor economy (including major events and conventions, friends and family, international education) are significant export earners and sources of employment for New Zealanders.

Tourism: the opportunities

International tourism visitor numbers are very likely (although not certain) to grow significantly over the next 20 years.

Research shows that most visitors come to New Zealand to experience our natural environment, including associated opportunities for adventure.

Our unique biodiversity and Māori cultural heritage have the potential to be increasingly valuable assets.

Tourism: the challenges

Growing visitor numbers are placing pressure on New Zealand’s most iconic tourism destinations. At peak times, these places are becoming congested, with risks to the quality of the visitor experience, to the support of locals for tourism and to local environmental sustainability and biodiversity.

Local infrastructure, such as car parks and toilets, has come under increasing pressure in several areas. Councils with small ratepayer bases relative to the scale of tourism have struggled with funding.

Many tourism-related jobs are part-time (because of the seasonality of demand), relatively low wage/low productivity, and with limited prospects for career development. Parts of the sector have become heavily reliant on migrant labour (mainly on student or working holiday visas).

The international and national travel associated with tourism is a source of carbon emissions.

Tourism and the PGF

Spreading visitor demand across more regions and sub-regions would enable higher numbers to be accommodated with less congestion (other things being equal), would ensure that more regions/sub-regions benefited, and would contribute to improved outcomes for New Zealand overall.

A number of PGF regions have potential to attract increasing numbers of international (and domestic) tourists, subject to strengthening their value propositions.

Growth in tourism demand is one of the main prospects for increased job opportunities in surge regions.

PGF is an opportunity to make more of tourism, and to accelerate investment to tackle the infrastructure backlog.

Government (coordinated by MBIE) is developing a national framework to guide tourism investments and support regions to develop or refine destination development plans that address:

- Access to the region and its attractions
- Amenities, including accommodation
- Attractions: that encourage visitors to come, stay and spend
- Awareness: subject to the other enablers being in place, raising awareness should increase visitor numbers
- Attitude: action to build and sustain support from local communities for tourism.

Coordinated investments may be required to increase the probability of success.

PGF co-investments will be focused in the areas where the case for public funding is strongest e.g. in improving access to some regions, and in developing attractions (such as on the conservation estate) that will help attract more visitors to a region or sub-region. Tourism New Zealand will continue to co-invest in raising awareness of New Zealand and of attractive visitor itineraries in international markets.

PGF invites investment proposals that address one of more of the following:

- Reducing existing pressures on tourism-supporting infrastructure
- Adding to the value of tourism and the visitor economy, for example through developing high-value attractions
- Spreading demand beyond the traditional high season and to more regions
- Supporting the professionalisation of the workforce, enhancing prospects for career development and reducing reliance on migrant labour
- Enhancing the productivity of tourism businesses, for example through the uptake of digital technologies
- Enhancing the environment and improving outcomes for native ecosystems and biodiversity, for example through actions to reduce pressure on fragile eco-systems, to

improve the environmental practices of tourism businesses and to reduce the carbon intensity of tourism-related travel.

Further diversifying the national and regional economies

Further diversification of economic activity (products, services and markets) and investing in higher-value parts of existing value chains (e.g. agri-tech) creates new opportunities for future growth and enhances economic resilience - reducing vulnerability to shocks (such as an outbreak of foot and mouth, rapid uptake of plant-based protein or disruption in one of New Zealand's main export markets).

PGF welcomes credible proposals that will contribute to economic diversification in the regions, and nationally.

Investment attraction

PGF will also support NZTE's work in investment attraction. NZTE identifies investment opportunities in the regions and seeks to match to these opportunities with potential investors. Support for such investments is primarily facilitative (rather than financial), including helping to identify and (where appropriate) address regulatory barriers to investment.

PGF Investment Tier 3: Infrastructure

PGF is focused on two categories of infrastructure investment that are central to regional economic development: transport and digital enablement (including connectivity).

Transport

Transport networks that are fit-for-purpose for the safe and timely movement of people and freight are an essential enabler of economic development and of societal well-being, both regionally and nationally.

Central and local government have well-established processes for planning, funding and delivering land transport infrastructure.

Transport infrastructure: land transport planning and funding

The Government Policy Statement on land transport (GPS) sets out the Government's strategic priorities for land transport investment. The New Zealand Transport Agency (NZTA) gives effect to the GPS through the National Land Transport Programme (NLTP), which sets out the range of activities that will be prioritised for funding through the National Land Transport Fund (NLTF).

The NLTP is comprised of activities drawn from Regional Land Transport Plans (RLTPs). RLTPs set out regional transport priorities and are developed by local government with support from NZTA. RLTPs will remain the key mechanism for regions to plan and prioritise their transport needs. This means that projects considered for PGF funding will need to be included in regions' RLTPs.

Land transport infrastructure and regional economic development

The NLTF will continue as the primary source of funding for land transport activities. The PGF complements the NLTF by providing additional funding where a project opens up or advances economic development opportunities (thereby enhancing the productivity potential of the regions).

The PGF can assist in three ways:

- By providing a source of funding for local authorities that face significant difficulty in meeting local share requirements
- By bringing projects forward where they may not be prioritised under the NLTP but are strategically important to a region's productivity potential
- By providing a source of funding for projects that do not secure funding through the NLTF but which otherwise meet the government's criteria and objectives for the PGF.

The PGF can take an opportunity-focused view of transport investments and invest ahead of demand, recognising that transport investments may be needed to enable new opportunities for growth. Projects will need to provide strong evidence of expected benefits, showing how the investment would unlock growth opportunities or increase value of an economic activity.

RLTPs and regional economic development action plans or other strategies should be developed and refined in tandem. This will maximise the potential for PGF transport investments to help realise a region's growth strategy.

Developing and evaluating transport infrastructure applications to the PGF

All land transport projects will be subject to a robust and consistent standard of assessment using NZTA's methodologies, and taking into account PGF objectives and evaluation criteria.

All land transport projects will need to be included in RLTPs, as per the requirements of the Land Transport Management Act 2003, and regions should include other potential transport investments in RLTPs to ensure that they are recognised and prioritised by regions in the context of their wider integrated transport planning.

NZTA, MoT and PDU will work with local government to ensure that the relationships and processes across the two main funding sources (NLTF and PGF) are clear and as straightforward to interact with as possible.

Funding arrangements will be assessed case-by-case, and will take into account the overall financial position of local authorities, and the priority given to surge regions.

Wherever practicable, NZTA and PDU will pursue funding arrangements that allocate costs on a beneficiary-pays basis - for example, a dedicated road to a commercial forestry plantation.

Rail

Government is currently reviewing the role of rail within the overall transport system. The Upper North Island Supply Chain will also inform assessment of transport needs for the Upper North Island, including opportunities for rail. Any decisions made following these reviews will be incorporated into the PGF Investment Statement, as appropriate.

These work programmes will not stall PGF rail decisions. Rail initiatives, where they clearly contribute to the objectives and criteria of the PGF will continue to be considered. However, the decision-making process will take account of key policy work programmes underway.

Airports, ports and wharves

Investment proposals relating to airports, ports, wharves and other non-land transport infrastructure should demonstrate a clear link to PGF objectives.

New Zealand has a significant number of regional ports and airports, which have developed over a long period of time in response to continually evolving regional and national needs.

To some extent, ports compete for the same business. Expanding capacity at one port might reduce the need for expanded capacity at another. Investment in a port can create a need for complementary investment in the connecting road and rail networks, requiring a level of coordination over decision-making.

The same issues arise for airports. A primary role for a number of smaller provincial airports is to support tourism. Some airports are close enough to one another to be partial substitutes. Some may also service essential needs in more remote communities, such as access to health care, or emergency response needs.

MoT, NZTA and PDU will work with regions to build a shared understanding of these wider issues and interdependencies, which will inform advice on port- and airport-related investments.

Wharves tend to serve more local needs, which include the support of multiple forms of economic activity, such as fishing, marine and tourism.

For these long-lived asset classes, clarity on asset ownership and management of whole-of-life costs will be important considerations.

Digital Enablement

As with other countries, New Zealand has seen rapid growth in the digital economy and in uptake of digital technologies across society as a whole. Digital technologies change what it means to live and to do business away from main urban centres (notwithstanding that the worldwide trend towards urbanisation seems likely to continue).

PGF investments can help better digitally-enable regions and sub-regions: enhancing connectivity, growing the digital capability of citizens and businesses and enabling more innovation and digital (knowledge-based) employment.

A full range of digital capabilities creates a new and continuously evolving set of opportunities for regional communities and businesses.

Digital Enablement is a priority for the PGF, in particular proposals that combine elements of:

- Infrastructure co-investment to enhance connectivity - broadband and mobile
- Digital capability - for local citizens (prioritising groups that might otherwise not have access to the digital world) and local businesses
- Digital employment - introducing digital technology into existing businesses and supporting start-up of new digital businesses, including a focus on business sectors that are important in the regions: farms, tourism and construction.

Infrastructure proposals should not replicate or overbuild existing or planned infrastructure of equivalent capability.

The PGF welcomes proposals from within a region (or sub-region, e.g. for a particular town), but also national or multi-region initiatives that are focused on the surge regions and which engage local leaders and communities.

To ensure that any PGF proposals build on existing and planned government initiatives, Ministers have asked the Digital Economy and Inclusion Ministerial Advisory Group (supported by officials) to develop a framework to guide potential applicants on PGF priorities for investment, covering:

- Digital initiatives already underway or planned
- Evidence on what works in promoting digital enablement at regional and community levels
- Highest areas of digital priority from a national perspective.

PGF and Māori Economic Development

The scale, ambition and priorities of the PGF provide a major opportunity for Māori, who have:

- Unique cultural connections as a people and with the land, matauranga Māori and unique products and services that represent a point of difference in the market
- Deep place-based connection and kinship with the natural environment, and a strong desire to ensure that economic development is sustainable and balanced with spiritual, cultural and social aspirations.
- Significant collective land holdings in the regions, with some productive land under lease arrangements, and not all of which is being utilised to its full productive potential.
- Increasing amounts of investment capital available to further their aspirations.
- Already innovated in land management and sustainable development, and have a youthful population that provides potential future capability and leadership to take development to the next level.
- Significant numbers in the PGF surge regions.

PGF areas of focus are highly relevant to Māori:

- Food and fibre: some Māori are already at the leading edge of innovation in shifting the primary sector to higher value, environmentally sustainable production oriented toward meeting current and future domestic and international consumer demand – the PGF provides an opportunity to scale this up further and faster.
- Tourism: Māori culture is an important part of New Zealand's tourism proposition.
- Digital enablement: a means of enhancing the set of opportunities for young Māori in relation to their own careers, and to support innovation and productivity enhancements for Māori businesses.
- Supporting whānau into employment, notably through He Poutama Rangatahi.

Māori will be beneficiaries of PGF investment, indirectly and directly:

- Indirectly: as surge regions and sub-regions benefit from investments in such things as infrastructure, new forms of economic activity and capability-building
- Directly: as Māori groups are successful in submitting proposals to PGF that result in new economic and employment opportunities for Māori businesses and people.

PDU, in partnership with TPK, Māori Economic Development Advisory Board and IAP will engage with Māori to support the development of applications that will enable more Māori to enter the workforce and transition to higher quality jobs, and enable Māori businesses to diversify and grow, including internationally.

Operationalising the PGF

In operationalising the PGF, the starting point is the need to strike a balance between the urgent need to better-support economic development in the regions with the importance of obtaining value-for-money for the taxpayer and for the country as a whole.

The PGF was not established to make fully commercial investments in pursuit of fully commercial returns. SuperFund and ACC are examples of government funds that do invest in this way, to fund future pension and accident compensation payments.

But Ministers did establish the PGF as an investment fund.

The objective is to realise enduring benefits, in part by leveraging the capital of co-investors such as businesses, financial institutions, Māori, local government and philanthropists.

Co-investing, rather than dispersing grants, means that capital is returned, enabling further investment in regional development or other government priorities.

At a generic level, the PGF will commit funds to three categories of investment:

Non-commercial projects: investments that deliver public benefit but do not generate a revenue stream (e.g. capability building, some infrastructure projects such as a road improvement).

Quasi-commercial projects: investments that generate a revenue stream (as well as broader public benefits), but the revenue stream is not sufficient to be fully funded by the private sector (expected project returns are too low, relative to risk).

Commercial projects: investments that are able to be fully financed/funded by the private sector. The PGF would not expect to invest unless the investment delivers some public benefit that would not otherwise occur - for example, the public benefit of accelerating the development of a project that would occur anyway, but at a later date.

Rationale for taxpayer co-contribution in PGF proposals

At the level of individual proposals, the purpose of PGF is to purchase public value that would not otherwise be realised.

Examples include:

- Supporting NEETs into enduring employment in an area with a persistently above-average proportion of NEETs
- Regional or sectoral infrastructure that has multiple users and will enhance productivity e.g. through moving up a sector value chain
- Supporting entry into a new market that creates new opportunities for other New Zealand businesses
- Improved environmental performance (that is not already required by regulation).

PGF investments should not crowd-out private or public investments that would otherwise have occurred.

Cost-benefit analyses

For all proposals, expected benefits should exceed expected costs, taking account of risk and uncertainty.

At a project level, the PGF's objective is to maximise the ratio of the net present value of the expected public benefits to the net present cost of the investment to the Fund.

Benefits should be linked to PGF's objectives (the primary objective being to raise the productivity potential of the regions), can be widely defined (e.g. environmental or resilience-related, as well as economic), and are sometimes difficult to estimate. Applicants should be as specific as possible about the nature of the benefits, and about the range and extent of uncertainty in relation to their potential value.

Applications should set out whole of life costs and benefits, and be clear as to how ongoing operational and maintenance costs will be funded. PDU will provide guidance to applicants on the level of analysis required and on how to estimate costs and benefits.

Requirements for cost-benefit analysis will be proportionate to the scale and risk of proposals.

Major commercial projects, with whole-of-life costs in excess of $10 million will be required to submit detailed business cases using Treasury's Better Business Case methodology.

Well-established frameworks for cost-benefit analysis, such as the NZTA approach to evaluating transport investments, will be applied wherever relevant.

Co-contributions

Requiring co-contributions from applicants helps create strong incentives for good quality proposals (through having 'skin in the game'), and is a means to leverage others' capital to enhance the impact of the PGF in supporting regional economic development.

PGF will require a minimum 50% co-contribution for commercial and quasi-commercial co-investments.

Whether to require co-contributions for non-commercial applications will be considered on a case-by-case basis, within the context of the overall objectives of the Fund and the priority given to surge regions.

Co-contributions may not be required for applications that clearly deliver net benefits, and where there are strong elements of social and environmental rather than narrower economic benefits.

In-kind contributions will be considered where they are additional to business-as-usual and are not Crown funded (directly or indirectly); for example provision of a building and support staff to host a capability-building initiative.

Significant grants (in excess of $100,000) to business entities will require a co-contribution of 60 per cent, to ensure consistency with existing government grant schemes such as Primary Growth Partnership (MPI), R&D growth grants (Callaghan Innovation) and the International Growth Fund (NZTE).

PGF investments (debt or equity rather than grants) in commercial or quasi-commercial projects will require co-investment of a minimum of 50 per cent.

Co-investing with individual firms

Where there is a clear public benefit, PGF will co-invest with individual private sector businesses.

This will typically require that the benefits are shared beyond the sponsoring business itself.

The rationale for this form of co-investment needs to be particularly strong because of the information advantages that the business will typically have, and the risk that PGF will be perceived as a source of cheap finance.

An example of such a co-investment might be for a business that is proposing to invest in a new facility of some kind:

- If the location has above-average NEETs, the PGF might partner with the business to fund a range of apprenticeships for local people, with supporting pastoral care. Funding could be through a grant or suspensory loan, with the business incentivised to deliver sustained employment outcomes for local NEETs
- The PGF might co-fund a research facility attached to the facility, if the research is of value to the regional economy (e.g. research into monetising a local natural resource)
- The PGF could co-fund more extensive enhancements to the local transport and logistics network than might otherwise occur, because of the low incremental cost and the potential value to multiple parties (e.g. other local businesses, community groups)
- To mitigate demand/market risk in the early years of investment if potential returns (to the economy) are sufficiently high,

Co-investment with a business that generate sustainable jobs that are more productive and higher paid than would otherwise be present in that locality generate public value although, depending on the particular circumstances, this may only be to the extent of the average difference in wage for the new jobs versus existing jobs.

Local government and co-contributions

Local government is a likely partner for PGF in a range of potential investments, including transport infrastructure.

Central and local government are engaged in funding-related discussions across a range of areas of activity, including transport, infrastructure to support housing developments, tourism infrastructure, climate change adaptation and earthquake-prone buildings.

PGF and central government partners will work with local government entities to understand their overall financial position, capacity and priorities for co-investment. PGF's objectives in doing so will be to ensure that local bodies have incentives to prioritise potential PGF co-investments to realise maximum benefit and to allocate sufficient resource to meet their share of the costs. This will be more straightforward to the extent that local bodies have a full view of the set of investments that they plan to pursue through PGF.

In discussing the financial position of local government bodies, PDU will be mindful of the priority to support surge regions for which local government may be less well-placed to co-fund investments than is the case in other parts of the country.

PGF's relationship with other government programmes

A range of other government programmes also contribute to the overall objective of a productive, sustainable and inclusive economy.

Some potential PGF proposals will be better considered, at least in the first instance, in the context of one of these other government programmes.

Examples include Kiwibuild, the Green Innovation Fund, Primary Growth Partnership, Tourism, Infrastructure Fund, ongoing investment in tertiary education and science, Crown Infrastructure Partners and the National Land Transport Fund.

PGF will still consider funding proposals that fit within the criteria for an existing government programme, subject to each of the following criteria being met:

- The project will clearly not be funded by the government programme within which it best fits, or will not receive investment in sufficient time to unlock key opportunities or meet urgent needs in regions
- The project aligns well with the objectives of PGF
- The project has benefits that exceed costs, taking account of risk and uncertainty

PDU will work with applicants to ensure they understand the relationship between government programmes and how best to connect with other parts of government as appropriate.

PGF appetite for risk

Articulating PGF's appetite for risk is most relevant in relation to commercial and quasi-commercial investments. In relation to potential investments of these kinds, PGF will:

- accept risk for commensurate potential return (in the form of public value)
- seek partners who have the capability and resources (financial and non-financial) to carry through on their commitments over the life of the investment
- work with applicants to identify all material risks and to allocate each risk to the party best placed to manage it
- not directly take on project delivery risk, but utilise other government agencies to oversee delivery as appropriate e.g. Crown Infrastructure Partners
- minimise exposure in the event of a project getting into difficulty, including by not taking on any explicit or implicit role as funder-of-last-resort.

Risks in relation to infrastructure investments in transport and telecommunications will be assessed using the standard approaches of NZTA and Crown Infrastructure Partners respectively.

Range of financial instruments for Crown co-investment

The Fund will utilise a range of financial instruments when investing in commercial and quasi-commercial projects.

Grants

With grants, there is no requirement for repayment. A grant can be released in tranches, subject to successful delivery against specified milestones. As noted above, grants will also be used to co-fund feasibility studies.

Debt

With investment through debt, repayment is expected, subject to the financial performance of the project.

Options for the appropriate interest rate on debt include: fully reflective of the investment risk (i.e. a normal commercial arrangement), at concessionary rates or at rates that depend on financial performance.

The Fund will look for debt collateral that is as strong as possible, other things being equal. PGF will take into account, for example, the risk in seeking strong collateral of crowding out private sector debt sources.

Equity

Equity could be in the form of preference shares or ordinary shares. PGF will not take majority equity stakes.

In simple terms, an equity investment entitles the PGF to a proportionate share in any dividends and retained earnings and brings the rights and obligations that go with ownership.

In practice, equity can be structured to provide exposure to only certain risks (although not as easily as debt) and to provide preferential rights to capital/distributions over ordinary equity.

PGF does not expect to take majority equity stakes in investments.

Underwrite

This could take the form of the PGF agreeing to provide a capital contribution, in the event a capital raise by the project sponsor is not successful.

An underwrite might also be used to reduce the risk of demand uncertainty e.g. in relation to a tourism infrastructure investment, where the investment is part of a coordinated set of investments to enable a region to cater for increased visitor numbers, but where the rate of demand growth is uncertain.

A challenge with an underwrite is to ensure that incentives on the co-investor to seek private capital and to manage risks are not materially diminished.

Given this, it is unlikely that the PGF would deploy underwrites often.

Within these broad categories, there are many combinations and variants, which PDU will consider in order to appropriately shape incentives and to determine how risks and returns are allocated.

Criteria for instrument selection

As noted above, grants are likely to be the primary funding instrument for non-commercial projects.

For roading, rail and telecommunications, PGF will work with the lead government agencies (NZTA, Kiwirail and Crown Infrastructure Partners respectively) to ensure that funding arrangements conform to the normal arrangements for those sectors, but enable investments that would not otherwise occur or would occur later.

The full range of financial instruments is relevant to commercial and quasi-commercial projects (whether initiated by a private or a public entity), where there is a revenue stream that can be 'captured', and is sufficient to form the basis for payments to investors.

Potential role for equity instruments

The PGF will consider equity investments where this is the best way to achieve a public benefit and/or to best enable recycling of funds. This is more likely to be the case if one or more of the following are present:

- the project's capital structure cannot sustain any further debt (without crowding out material levels of debt from other providers)
- equity-like controls are desirable to mitigate risk (as opposed to debt-based controls)
- the Fund's equity position can be structured to be elevated above other equity participants.
- there is significant economic potential that the Fund could capture (although the stronger the expected returns, the less likely the case for Fund involvement in the first place).

Ranking potential financial instruments

For commercial and quasi-commercial investments, the PGF will generally rank:

- Debt ahead of grants, because:
    - debt provides a means for return of capital which can then be recycled
    - using debt is a means to ensure strong commercial incentives on PGF co-investors and enables utilisation of well-established contractual arrangements.
- Debt ahead of equity, because:
    - other things being equal, and depending on the details, return of capital is more likely for debt than equity (at the margin the difference can be negligible)
    - debt is a better mechanism to enable PGF to be more specific about the risks to which it is exposed.

Assessing project costs and benefits (under different scenarios) and the Fund's target risk exposure will be critical for assessing the appropriate instrument to use.

Measuring success for the PGF

Cabinet agreed to a set of success measures for review and approval by Ministers before the end of June 2018.

For 2018-19, measures will be of such things as the number, quality and spread of proposals into the Fund, and the rate of conversion of proposals into approved investments. A focus will be on the proportion of proposals from surge regions and from Māori applicants.

The PDU may also survey stakeholders on their experience in interacting with government through the PGF and the extent of PDU's responsiveness.

These will be complemented in 2019-20 by measures of the extent to which the emerging investment portfolio is a good match to the PGF's objectives.

The PDU will also track the benefits that will be delivered by approved investments, and assuming successful delivery. This will include estimates of net present value, jobs created and reductions in future benefit payments, environmental improvements (including emissions reductions, improvements to water quality, biodiversity and eco-system health), infrastructure benefits (such as improved connectivity in telecommunications and transport), contribution to productivity improvements and growth in Māori employment and in the value of Māori businesses.

The One Billion Trees programme will have a specific set of success measures, including number of trees planted, and projected.

PDU will contribute to the outcome measures being used by Government to track progress in the building of a productive, sustainable and inclusive economy.

The PDU will commission an independent evaluation of the PGF. The PDU is working with evaluation experts to ensure that the data collection arrangements to inform a subsequent evaluation are put in place at the outset.

Supporting stronger economic performance in the regions is a long-term endeavour

The PGF and the creation of the cross-government Provincial Development Unit is an opportunity to:

- Develop and embed new and integrated ways for central government to work in and with regions
- Support more effective and unified regional economic development leadership, including through shared investment in capability and improved tools and data
- Utilise all relevant government levers in support of better regional economic outcomes, potentially including: influencing the evolution of relevant policy and regulatory systems, influencing regional expenditure on tertiary education and social development, procurement, location of knowledge-based government jobs, immigration settings, eco-systems supporting start-ups, innovative and exporting businesses, partnering with the private sector
- Strengthen regional capability to adjust dynamically and pro-actively in the face of ongoing change.

PDU will work across the system in Wellington and with each of the regions to help integrate national strategies and priorities with bottom-up initiatives generated in and owned by regional leaders, including from iwi, businesses and communities.

One of Ministers' expectations of the PDU is that it help build a set of capabilities in central government and in the regions, with associated relationships, tools and data, to enable effective support of regional economic development well-beyond the end of the three-year life of PGF.

Annex 1: Administering the Fund

The Minister for Regional Economic Development is the Minister responsible for PGF, working with a group of Regional Economic Development Ministers, which also includes the Ministers of Finance, Economic Development and Transport.

Cabinet retains oversight of PGF and will make investment decisions of $20 million or more. Decisions on investments between $1 million and $20 million will be made by Regional Economic Development Ministers (in consultation with portfolio Ministers as appropriate). Investments of below $1 million are made by Senior Regional Official.

Multiple parts of government have a part to play in ensuring PGF is effective.

Ministers have established an Independent Advisory Panel to provide independent and objective advice to Ministers on investment proposals to PGF and support the building of a balanced and coherent portfolio of investments.

The Provincial Development Unit (PDU) has been established as a cross-government team that will lead implementation and administration of PGF.

PDU will work with and support Senior Regional Official (SROs). SROs are senior public servants each of whom leads central government engagement in and with a region; SROs also work as a cross-region team.

PDU will lead and coordinate government's overall work programme in and with regions, in support of regional economic development and in the building and updating of regional economic development action plans.

PDU works closely with government agencies that have teams located in the regions, including Te Puni Kokori (TPK), Ministry for Primary Industries (MPI), New Zealand Trade and Enterprise (NZTE), New Zealand Transport Agency (NZTA), Department of Conservation (DoC) and Ministry of Social Development.

The Ministry for Primary Industries (MPI) leads government existing programmes to support and develop the primary sector and food and fibre industries and will play a role in generating proposals in these areas. It is also leading delivery of the One Billion Trees programme, working with DoC, PDU, local government, Māori and business.

Te Puni Kokiri (TPK) works with Māori in areas that are central to PGF, including supporting young people into employment and support for Māori business.

Māori Economic Development Advisory Board works with MBIE, MPI, TPK and other government entities to support Ministers in delivering on Crown's part in He Kai Kei Aku Ringa: the Crown- Māori partnership to support Māori economic development.

New Zealand Trade and Enterprise leads government's existing programmes to support exporters and to attract inward investment, including to the regions, and will play a role in generating proposals that can accelerate activity in these two areas.

The Ministry of Transport and NZTA will work with PDU, local government and business to develop and evaluate potential investments in regional transport infrastructure.

Crown Infrastructure Partners will support PDU in evaluation and, potentially, implementation of proposals in relation to telecommunications connectivity.

PDU is charged with ensuring that government is coordinated in its interaction with PGF applicants, and in making the navigation of the relevant parts of government as straightforward as possible.