

## Health NZ Capital Funding Sources - the Vote Health Capital Appropriations and Baseline Depreciation

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<b>To:</b>	Hon Simeon Brown, Minister of Health		
<b>From:</b>	Jeremy Holman, Chief Infrastructure and Investment Officer Infrastructure and Investment Group		
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<b>Consulted</b>	Ministry of Health		

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## Purpose

1. This Aide-Mémoire responds to your request on 10 February for information on Health New Zealand | Te Whatu Ora (Health NZ) capital funding sources.

## Summary

2. This Aide-Mémoire provides advice on:
  - a) Capital settings (the decision rights for all investments) including the delegations for the approval of investments, the use of funding arrangements, the expectations for investment, and asset management.
  - b) How capital projects in Health are funded, including information about capital appropriations and depreciation funds.
  - c) How much Health NZ received for capital funding from the Crown, and how much capital funding Health NZ has spent.
  - d) An overview of how much Health NZ has set aside for depreciation and how this is allocated.
  - e) Portfolio Contingency for project cost pressures.

## Capital Settings

3. Capital settings are the decision rights for all investments, including the delegations for the approval of investments, the use of funding arrangements, the expectations for investment, and asset management. The overall framework for investment decisions across the state sector is set out in the Treasury's investment management system guidance. The core principle underlying the framework is to provide Ministers visibility and assurance of high-risk expenditure.
4. In April 2022, Cabinet agreed to specific capital settings for Health NZ. These brought the health system in closer alignment to state sector wide settings. This included the intent for the progressive increase in the delegations for health as we demonstrate the capability necessary for the enhanced management of the asset and investment portfolio, thereby creating a progressively more enabling system (SWC-MIN-22-0063, refers). Table One sets out the current capital settings.

**Table One: Capital Settings established for Health NZ**

	Health NZ Board	Minister of Health	Cabinet
Whole of life cost	Up to \$25 million	\$25 million up to \$100 million	Over \$100 million
OR			
Risk level	Low and medium		High

5. Table Two sets out the proposed progression of settings. However, Health NZ remains at the first stage and has not progressed to Stage 2 and 3.

**Table Two: Proposed progression of capital settings in Cabinet decision**

Stage 1 (Current Settings)	Stage 2	Stage 3 (From 1 July 2024)
<b>Based on whole of life cost:</b>  Up to \$25m – Board Approval  Up to \$100m – Minister Approval  Over \$100m – Cabinet Approval	Specific decision rights sought through submission to Ministers of the asset management and investment plans.	<b>Based on whole of life cost:</b>  Up to \$50m – Board Approval  Up to \$200m – Minister Approval  Over \$200m – Cabinet Approval

6. s 9(2)(f)(iv)

## Capital projects funding

7. Health capital projects are funded through the following sources:
  - a) Health NZ depreciation, accumulated as an operating expense.
  - b) Crown Capital (capital appropriations within Vote Health).
  - c) other funding sources.
8. There are two significant capital appropriations within Vote Health:
  - a) The Health Capital Envelope (HCE) which is discussed further below.
  - b) The New Dunedin Hospital appropriation.
9. Other funding sources include:
  - a) State Sector Decarbonisation funding (Crown capital appropriated within Vote Health and Health Capital Envelope). For Health NZ, the Energy Efficiencies and Conservation Authority (EECA) administers these funds, which is available for projects that meet decarbonisation criteria.
  - b) External donations - these may be sourced either through direct philanthropic engagement (such as with the Wellington Children’s Hospital), or through other charities set up for specific hospitals e.g. Starship Foundation.
  - c) Lease financing.
  - d) Insurance proceeds, claims against warranties, and proceeds from litigation.
  - e) Proceeds from sale of assets.

10. Most Health infrastructure projects are funded through the HCE and depreciation funds. Before the start of each financial year, Health NZ will approve a capital plan that has captured all capital funding sources. Most of the capital plan is delivered by three asset portfolios: Facilities/Infrastructure, Clinical Equipment (Health Technologies), and Digital Services.
11. The breakdown of funding across asset types in the 2024/25 financial year is shown in Table Three below. Table three includes all projects and planned capital expenditure for Health NZ, including both major monitored projects (HCE funded projects) and projects funded solely through depreciation:

**Table Three: Financing Plan for 2024/25 Capital Expenditure (initial projections)**

Financing plan for 2024/25 Capex					
	Health NZ Cash (\$m)	HCE / Crown (\$m)	EECA Loans /Grants (\$m)	Other (\$m)	Total Funding (\$m)
Facilities	365.86	1,033.47	50.86	13.62	1,463.81
Digital Services	170.63	29.59			200.22
Clinical Equipment	319.30			9.55	328.85
Motor Vehicles	19.03				19.03
Other equipment	12.93				12.93
<b>Total</b>	<b>887.75</b>	<b>1,063.06</b>	<b>50.86</b>	<b>23.16</b>	<b>2,024.83</b>

12. s 9(2)(g)(i)

13. Table Four provides an outline of the different sources of funding for the major monitored projects (HCE funded projects) that are in-flight (the 66 projects of \$6.3 billion value that are regularly reported in the Health Capital Update monthly report).

**Table Four: Funding sources for all major monitored projects (based on latest cash forecast)**

	Spend as at 30 June 2024 (\$m)	FY2024/25 (\$m)	FY2025/26 (\$m)	FY2026/27 (\$m)	Outer Years (\$m)	Total Project Cost (\$m)
Depreciation	62.489	63.979	103.939	79.197	4.406	314.011
Crown	1,710.134	1,183.452	528.556	1,089.559	1,431.346	5,943.047
Donations	12.630	6.000	4.970	0	50.000	73.600
<b>Total</b>	<b>1,785.253</b>	<b>1,253.431</b>	<b>637.466</b>	<b>1,168.756</b>	<b>1,485.751</b>	<b>6,330.658</b>

## Crown Capital

14. Crown capital includes any capital funding appropriated through Vote Health. Crown capital typically refers to the HCE. The HCE is a multi-year appropriation established for the provision or purchase of health sector assets, providing capital for new investments.
15. The HCE is a single appropriation within Vote Health that contributes in part or fully to most major monitored projects, aside from the New Dunedin Hospital. As an appropriation within Vote Health, it is administered by the Ministry of Health (Ministry). Funding within the HCE is not appropriated to specific projects. Specific allocations of HCE funds are instead subject to decision making by the Minister of Health and Cabinet.
16. In practice, the Ministry advises Health NZ on the allocation of funding to certain projects following the annual Budget process. Specific funding decisions are then noted within Cabinet minutes or on Ministerial decision papers and advised to the Treasury. Trade-offs can be made by the Minister of Health.
17. Funding from the HCE is decided on a commitment basis. In accordance with the Public Finance Act requirements, at the time a project is committed to, the total allocation of Crown funds must be set aside at the time of the decision.
18. Other funding mechanisms exist for the use of Crown capital funds that are not used, or not widely used, in Vote Health. This could include:
  - a) Establishing tagged contingencies to set funds aside for projects prior to business cases being completed.
  - b) Establishing specific appropriations for individual projects, as with the New Dunedin Hospital.
  - c) Undertaking one-off capital to operating transfers to enable early project planning (for example site master planning or clinical service planning). This approach has been used for the Regional Hospital Redevelopment Programme. As the funding has been ring-fenced for those projects, it has allowed them to continue with quality planning while other funds are considered within the reset.
19. The last Crown funding appropriated for new projects occurred in Budget 2022, prior to the establishment of Health NZ. Budget 2022 allocation was to cover funding for two financial years (2022/23 and 2023/24). The current portfolio of investments funded by the HCE includes:
  - a) Funds appropriated through Budget 2022 or earlier Budgets.
  - b) No new capital was appropriated to Vote Health in Budget 2023.
  - c) Through Budget 2024, \$103 million in new capital was appropriated to the HCE. The Estimates of Appropriations notes that the funding was intended to provide a centralised risk contingency pool for Health NZ. The contingency was to cover pressures related to projects approved in Budget 2022 or earlier.
20. The role of Health NZ in relation to the HCE is to:
  - a) Plan and deliver projects funded through the HCE on budget, on time and within scope.

- b) Report on actual and forecast expenditure, including any cost pressures within the in-flight portfolio.
  - c) Advise Ministers, the Treasury and the Ministry on priorities for new investment.
21. Health NZ has no authority to allocate HCE funds to specific projects. Where pooled funds are appropriated (as with the HCE), the Ministry has advised Health NZ on the projects these funds are allocated to.

## Depreciation

22. Depreciation is a non-cash cost funded through the annual Vote Health operating budget for Health NZ.
23. Health NZ depreciates its assets over their useful life. The annual depreciation budget is based on when the assets are commissioned into service. Health NZ typically uses a range of depreciation rates depending on the asset being depreciated.
24. The cash funding received for depreciation is set aside to fund the purchase of capital assets. Ideally the funding is meant to be used to replace existing assets. Depreciation funds are allocated annually and budgeted for on a cashflow basis. This includes funds for major monitored projects that are sourced from depreciation funding.
25. Total demand for investment often exceeds available funds and depreciation funds are often prioritised to address the immediate clinical service risk over addressing the degraded condition of assets. This has in the past resulted in depreciation funding being used for capacity, enhancement of services, and technology upgrades, resulting in a backlog of deferred asset replacements.
26. The total depreciation (table five) generated from buildings/facilities assets versus the depreciation allocated to facilities asset for the last three years is as follows:

**Table Five: Actual depreciation from facilities vs capital plan funding for facilities**

	Actuals depreciation generated buildings / facilities \$m	Capital plan Budget for facilities \$m	% of generated depreciation allocated to facilities	Total Health NZ depreciation funded capital budget \$m	% of Health NZ depreciation budget allocated to facilities <sup>^</sup>
2022/23	436,284	328,050	75%	790,716	41%
2023/24	528,079	519,437	98%	845,638	61%
2024/25	542,242 <sup>1</sup>	365,858	67% <sup>2</sup>	887,750	41%

\*: 2024/25 is budget not actuals

27. Infrastructure projects often have multi-year life spans. As depreciation funds are prioritised on a cashflow basis on a year-on-year basis, this results in a large proportion

<sup>1</sup> Facilities assets have a longer useful life than other assets, therefore depreciation generated by facilities assets is not always fully allocated to the replacement of facilities in any given year.

<sup>2</sup> s 9(2)(g)(i)

of Health NZ's depreciation budget being prioritised "top-sliced" prior to the start of the new financial year.

28. Health NZ is currently delivering the Asset Management and Information Management System (AMIS) and is expected to have campuses migrated by June 2025. The AMIS will maintain a real time record of building, plant, infrastructure and land assets across the estate. As part of the National Asset Management Strategy, approved in December 2024, the Commissioner endorsed \$21million over six years (subject to funding prioritisation) to complete a baseline assessment of the estate which will audit the assets we have and their condition.
29. Without the AMIS and the supporting information on the condition of those assets in place, Health NZ relies on local assessments of clinical and asset risk to identify priorities for depreciation funds. These are assessed based on a nationally led criteria and prioritisation approach.
30. The breakdown of depreciation funds for the 2024/25 financial year, as budgeted, are shown in the table six below. This table shows the budget for infrastructure projects only.

**Table Six: Financial Year 2024/25 Depreciation Funds Breakdown**

Cost element	Notes and assumptions	Total \$ml
Committed funds	Pre-committed funds to existing Health NZ projects	s 9(2)(b)(ii)
	Energy Transition Plan	
	Cash contributions to major monitored projects	
Contingencies and pooled funds	Nationally held contingency	
	Capitalisation of staff costs commercial and negotiation	
	Fit out of leases	
	Seed funding for business cases	
	Asset Management Information System	
	Regional portfolio for very minor capital works (direct purchases)	
	Regional contingencies (\$1m each)	
New funding for projects	New Projects Northern Region	
	New Projects Te Manawa Taki Region	
	New Projects Central Region	
	New Projects Te Waipounamu Region	
<b>Total</b>		<b>365.858</b>

31. Available funding within 2024/25 meant over 400 infrastructure projects (of variable scale) assessed as high risk by the regions, were not approved for funding.

## Allocation of funding

32. While planning for new capital infrastructure initiatives, Health NZ typically follows the following general principles when preparing advice:
  - a) Where possible, projects should seek the use of a single funding source.
  - b) Where feasible, depreciation funds should be used for replacement of assets rather than expansion of services.
  - c) Depreciation funds should be prioritised on the basis of risk to clinical services.
  - d) A national contingency should be maintained in the HCE and depreciation budgets, for arising cost pressures. Cost pressures occurring following tender processes or during construction often require decisions within funding years.
33. The above principles are used to generate working assumptions for inputs into capital intentions and budget submissions. Historically, the Ministry and District Health Boards would fund projects using a mix of both Crown capital and District depreciation funds. This was intended to minimise the demand for Crown capital while ensuring local funds were spent.
34. Health NZ prefers to use single funding sources for projects. Overall, this greatly simplifies project accounting and reduces associated administration. As all capital demand is coming from one entity, the previous approach also does little to reduce the level of funding being sought from the Crown.
35. Health NZ's depreciation funds are oversubscribed by high-risk infrastructure, digital services, and clinical equipment projects across the country. Use of multiple funding sources results in trade-off decisions being taken on minor projects and adds to the overall level of pre-commitment on depreciation.
36. Ultimately, Health NZ does not take a view on decisions related to funding sources. Adjustments are made to the capital plan based on the outcomes of decisions taken by Ministers on investments, on the advice of the Ministry and the Treasury.

## Portfolio Contingency for project cost pressures

37. As Health NZ does not have access to any tagged contingencies for HCE funded infrastructure projects, maintaining a level of unallocated funding within the HCE as a contingency retains Ministers options for managing unexpected cost pressures as they arise. Without access to a Crown contingency, any cost pressures would require trade-offs or deferral of projects, or Cabinet approval of new capital.
38. The approach of maintaining a centralised contingency is consistent with Budget 2022 and 2024 decisions, both of which included contingent funds explicitly for the management of cost pressures available for allocation by Joint Ministers.
39. However, no contingency funding is being considered within the Budget 2025 process. As a result, any remaining available contingency would need to be allocated from the existing HCE multi-year appropriation or managed through trade-offs within the 2024/25, 2025/26, and outer financial years depreciation baseline funding.

40. s 9(2)(b)(ii), s 9(2)(j)

### Next steps

41. We will provide you with advice on the overall status of the HCE, and decisions taken on it to date, in due course.