

BOARD PAPER

Paper no:	14/08/0854
Meeting date:	15 August 2014
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Board function:	National Land Transport Programme 2015-18
Subject:	Key changes to the Investment Assessment Framework for the 2015/18 NLTP



PURPOSE

1. To seek Board approval on the key changes to be included in the development of the NZ Transport Agency's Investment Assessment Framework.



SUMMARY

2. A new assessment framework is required for the development of proposals for the 2015/18 National Land Transport Programme in response to changes arising from the draft Government Policy Statement on land transport as well as a number of business process improvements. An independent review of the framework considers it to be well aligned with international best practice.
3. The key changes incorporate the increased focus for resilience in the draft GPS, assessment for the new regional improvements activity class, and alignment with the business case approach. The changes also clarify the purpose of each assessment factor, increased transparency of the framework and the reasons for investment decisions, and better positioning of the benefit and cost appraisal undertaken for improvement activities.
4. We intend to communicate the changes as a draft assessment framework, as part of the investment signals to the sector in early September 2014. Part of the engagement will be on how we operate the new regional improvements activity class. The assessment framework can only be finalised after the GPS is finalised by the Government.



RECOMMENDATIONS

5. That the New Zealand Transport Agency Board
 - a) **Note** that an independent review of the NZ Transport Agency investment assessment framework indicates that it is well aligned with international practice in using both multi-criteria and cost benefit analysis.
 - b) **Agree** to changes to the investment assessment framework to reflect the draft Government Policy Statement on land transport 2015/16 to 2024/25, being:
 - i. Assessing resilience as one of the key level of service considerations.
 - ii. Assessment for the new regional improvements activity class using the same assessment criteria for state highway and local road improvement activity classes with the addition of defining eligible districts and using the regional improvements activity class to prioritise investment beyond the national priority threshold in these districts.
 - c) **Agree** to changes to the investment assessment framework to improve clarity and effectiveness, being:
 - i. Alignment with the business case approach and principle based assessment criteria.
 - ii. Increase understanding of the framework by rationalising assessment criteria and clarifying the purpose of each assessment factor.
 - iii. Enabling innovation by changing the assessment of effectiveness and efficiency to allow managed risk for higher return in our high priority areas.
 - iv. Changing the name of the 'economic efficiency' assessment factor to 'benefit and cost appraisal'.

- v. Changing the benefit cost ratio thresholds from “1, 2 and 4” to “1, 3 and 5” within the benefit and cost appraisal rating bands.
- d) **Agree** to changes to improve transparency by reporting on the reasons behind each assessment, particularly the results being addressed and quantitative benefit and cost appraisal.
- e) **Agree** to the release of the draft investment assessment framework as part of the investment signals to the sector early in September 2014.
- f) **Note** that we are doing work to determine the best balance between qualitative and quantitative assessment factors and what changes might be appropriate for 2015/18.



BACKGROUND

6. It is an independent role of the Agency to approve an assessment system for projects to be incorporated in the National Land Transport Programme and hence their eligibility for funding. The Investment and Revenue Strategy (IRS) defines our current assessment and prioritisation framework. It is the main mechanism we use to ensure that we give effect to the Government Policy Statement on land transport when developing the NLTP.
7. A “new” investment assessment framework (IAF) will replace the “old” IRS for the development of the 2015/18 NLTP. We are working with the Ministry of Transport to ensure there is a shared understanding of the improvements to be incorporated into the IAF for the 2015/18 NLTP and for the longer term.



INDEPENDENT REVIEW OF ASSESSMENT FRAMEWORK

8. An independent review by Ernst & Young compares our assessment framework to Sweden, the United Kingdom, Australia, Germany and the Netherlands. These countries have been selected on the basis of representing international best practice for transport assessment frameworks. All these countries use cost benefit and multi-criteria analysis but each in a different mix and at different stages. Some use both approaches alongside each other like our system and some use multi-criteria analysis as a “gateway”. In all these countries, multi-criteria analysis is used as a mechanism for policy discretion and each approach is tailored to their respective transport funding systems. Refer to attachment 1 for the preliminary findings from the draft report.
9. The draft findings are that we are well aligned with international practice but there are possible changes for the short and longer term. Suggestions for improvements for the 2015/18 NLTP focus on increasing transparency by:
 - setting out the framework and process clearly
 - clearly expressing how non-monetised impacts are considered
 - improving communications around project selection
10. Improvements for the longer term to consider for the 2018/21 NLTP include:
 - Reviewing the balance between qualitative (the current strategic fit and effectiveness) and quantitative (the current economic efficiency) assessment criteria, including:
 - the appropriate role of policy discretion (mainly expressed within our current strategic fit) in the decision making process
 - the balance be consistent at all stages of the decision making process

- Improving the integration between the assessment framework and the business case approach
 - Reviewing the economic efficiency assessment
 - Whether there is scope to monetise more impacts
 - How non-monetised impacts be reflected
11. We consider that improvements to transparency can be incorporated into the draft assessment framework and form part of the investment signals to approved organisations developing their regional land transport programmes for the 2015/18 NLTP.
12. We also consider that integration with the business case approach can be progressed for the 2015/18 NLTP. This helps clarify the purpose of assessment and removes overlaps where some current assessment criteria are related to demonstrating good process, which the business case addresses or the use of particular tools and solutions, which the business case precludes. We think we can potentially progress now some aspects of the suggestions for the longer term reform to review the balance between qualitative and quantitative assessment criteria.

PROPOSED CHANGES

13. We seek to present our assessment framework in a more principle-based form across activity classes, rather than as the specific guidance for each activity class of the current IRS. Where detailed guidance is required, it will be incorporated in our operational documents rather than the framework level of the IAF.

14. At a principle level, three assessment factors will continue to help determine value for money. In the current framework they are described as:
- Strategic fit = right things, issue/opportunity and line of sight to GPS results
 - Effectiveness = right way, proposed programme/activity to deliver GPS results
 - Economic efficiency = right price, the best whole of life benefits and costs
15. The possible improvements to the framework can be grouped into three broad categories.
- Changes identified in the independent investment assessment framework review
 - Rationalise assessment criteria to clarify purpose and remove overlaps
 - Increase understanding of the assessment framework
 - Increase transparency of investment decisions
 - Align with the business case approach
 - Balance between qualitative and quantitative assessment
 - Changes in response to the draft GPS
 - Proactive handling of resilience and new supporting guidance
 - Regional improvements activity class assessment
 - Response to improvements in our tools and business processes
 - Enabling innovation
 - Changes to efficiency assessment



CHANGES IN RESPONSE TO THE DRAFT GPS 2015

Proactive handling of resilience and supporting guidance

16. The draft GPS raises the profile of having a reliable and resilient land transport system. The current assessment for resilience deals with reactive responses. Changes are proposed so that proactive activities for resilience will be explicitly assessed as a key level of service consideration. Supporting detailed guidance for resilience in the level of service considerations include the probability of events and function of the transport link according to the One Network Road Classification.

Assessment for the regional improvements activity class

17. A significant new initiative in the draft GPS is the new regional improvements activity class to replace regionally distributed 'R' funding that expires in March 2015. Existing policies for 'R' funding remain in place for any residual 'R' funds.
18. The new regional improvements activity class is different from 'R' funds. The key features are:
- it is a single nationally contestable fund rather than a set distribution across regions
 - it is designed to allow a regional focus on national priorities
 - key tourist routes are an additional specified focus
 - it is restricted to road improvements
19. The recommendation for assessing regional improvements is to use the relevant criteria for road improvements rather than establishing separate criteria, and define eligible areas. This approach simplifies administration and compliance for approved organisations.

20. The regional improvements funding range will allow investment beyond the national threshold within relevant activity classes and enables investment to reach into the areas that do not have sufficient national priority. This means that proposals on routes with lower volumes, or individual rather than collective safety risk, will be raised in priority for investment.
21. We wish to start sector engagement on operationalising this activity class through the assessment framework, to help us deliver on its intent. This will need to be carefully managed because the GPS remains a draft.



CHANGES PROPOSED FROM OUR IMPROVEMENTS IN TOOLS AND BUSINESS PROCESSES

Alignment with the business case approach and principle based assessment criteria

22. The current IRS specifies a number of tools within the strategic fit and effectiveness assessment, as a way of identifying investment priorities in a 'where and how' approach. The better business case approach precludes this approach so the tools should be replaced with outcomes. There will be some cases where reference to tools remains valid, but the principle should be to refer to outcomes as a first preference. Proposed changes are listed below.

Tools mentioned in the 2012/15 IRS strategic fit factor	Proposed 2015/18 change to focus on outcomes in the strategic fit factor
Road classification State Highway Classification System National strategic state highways Regional strategic state highways	Customer Levels of Service from One Network Road Classification

Safer Journeys	Number of Deaths and Serious Injuries
Model walking/cycling communities	Contribution to improving network capacity
Fare box recovery rates	Include in efficiency assessment

23. The current IRS contains a significant repetition across activity classes for the strategic fit assessment, whereas the effectiveness assessment is generic across all activity classes. The business case approach requires a focus on identifying and delivering outcomes and we have a more multi-modal approach than before. This suggests that we should take an activity class neutral approach to assessing strategic fit.
24. The suggested change is to rationalise within the assessment framework and focus on outcomes, removing references to tools and solutions. This helps keep options and alternatives under consideration for as long as possible. For some specific activity classes or activities there may ultimately be a need to tailor at a detailed level.
25. This change alongside clarifying the purpose of individual assessment criteria will help with the short term reform to clearly express how non-monetised impacts (or “results” in the terminology of the draft GPS) are considered.

Enabling innovation

26. We wish to incorporate innovation in the assessment framework through enabling managed risk taking. In some of our priorities (efficient road maintenance, public transport, road safety, and more efficient freight movements) we seek ambitious changes in delivery, and hence we may accept a higher level of delivery risk for potential greater return. The current IRS is neutral to slightly negative with regards to innovation, particularly in the effectiveness and economic efficiency assessments.

27. A specific assessment 'module' will be created to handle innovation and follow the research assessment framework where a higher level of uncertainty of successful delivery is accommodated in the effectiveness and economic efficiency assessment. Associated with this managed risk approach is a requirement for reporting on the lessons learnt.

Changes to efficiency appraisal

28. The 2013 changes to our Economic Evaluation Manual introduced a reduced discount rate of 6% and extended evaluation period of 40 years. This has the effect of increasing benefit cost ratios (BCR) by up to 30% for longer term investments. These changes mean that activities may be raised in priority, including those previously with BCRs below 1. Increasing the thresholds within the bands is proposed to maintain granularity in the framework and incentivise increased efficiency. For example, once a project appraisal reaches a particular threshold, it can be assumed to be fundable and further efficiency gains are not readily sought.
29. As the benefit and cost appraisal is a quantitative assessment, it does not need high, medium, low ratings in the same way as the qualitative assessments do (strategic fit and effectiveness). We will band the benefit and cost appraisal into ranges of 1 to 3, 3 to 5 and 5+ as an initial filter for distinguishing activities for NLTP development, followed by a finer grained approach when making investment decisions in conjunction with the quantitative assessment factors.

2012/15 economic efficiency		2015/18 benefit and cost appraisal	
Rating bands	Descriptor	Rating bands	Descriptor
BCR \geq 1 and $<$ 2	Low	BCR \geq 1 and $<$ 3	1 to 3
BCR \geq 2 and $<$ 4	Medium	BCR \geq 3 and $<$ 5	3 to 5
BCR \geq 4	High	BCR \geq 5	5+

30. A change to the name of the assessment to benefit and cost appraisal is proposed. The change will eliminate perceptions that this as a measure of economic growth and correctly describe it as a measure of delivery efficiency.

Clarify the language and presentation of assessment

31. There is a lack of transparency on the reasons behind our investment decisions. Although we do publish our investment decisions this concentrates on the funding profile (e.g. HMH), costs and process matters. Reporting on the driver for investment is important to identify the priorities being addressed and how the investment delivers on the priorities. A more comprehensive picture of investment decisions will be available through identifying the outcome sought and how well it might be delivered rather than just reporting the profile.
32. Reporting of the actual BCR from the benefit and cost appraisal at funding approval, instead of the old “efficiency” rating band, is recommended for increased transparency. This adds to the increased transparency for the reasons behind the strategic fit and effectiveness assessment.



BALANCE BETWEEN QUALITATIVE AND QUANTITATIVE

33. The old IRS is based on a prioritisation that places strategic fit first, followed by effectiveness and then efficiency. This means that we put greatest weight on identifying the right things to do, followed by the right way, and then assessment of benefits relative to cost.
34. It has been suggested that efficiency (being quantitative) should be the first consideration. Although conceptually simple, the implications are significant as it assumes that efficiency is a better measure of value for money than the other assessment criteria. This change is not recommended at this time.

35. Swapping the order of efficiency and effectiveness has a relatively minor impact. We saw this in the differences between 2009/12 (when this approach was applied) and 2012/15 NLTP. For example, a more traditional transport approach such as isolated spot safety or efficiency treatments, will tend to rise in priority at the expense of activities that take an integrated corridor or network approach.
36. Another approach is to assemble the assessment criteria for prioritisation in a different way. We wish to investigate an approach of using strategic fit and effectiveness as an initial qualitative assessment (the policy discretion acting as a type of decision gateway for transport issues worth pursuing further), with greater granularity at a subsequent stage from the quantitative economic efficiency assessment. This should also help to better separate the qualitative and quantitative and eliminate the perception that two qualitative assessment criteria dominate over the single quantitative efficiency assessment.
37. We have not fully developed this concept and need to determine the exact form and potential impacts of this approach. We aim to test this approach and report at the 15 August Board meeting as to whether it is practicable to develop for the 2015/18 NLTP or in the longer term.



RISKS

38. Developing a draft IAF based on the draft GPS risks substantial rework, if the final GPS differs substantially from the draft.



FINANCIAL IMPLICATIONS

39. There are no financial implications to this paper.



COMMUNICATION AND ENGAGEMENT

40. The draft IAF will form part of the investment signals to the sector early in September 2014 that are described in Board paper 14/08/0849.

41. Part of this engagement with approved organisations will be on the assessment criteria for the regional improvements activity class. This is a significant new initiative within the draft GPS and quite different from the existing R funding policy that it replaces.



ATTACHMENT

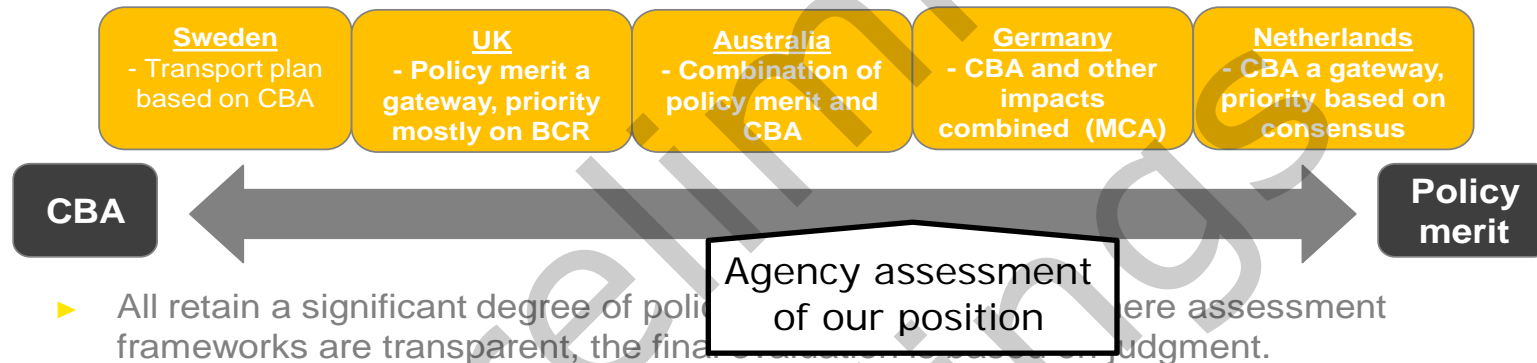
42. There is 1 attachment.

- Preliminary findings from the independent review

Attachment 1: Preliminary findings from the independent review

Key lessons learnt from international comparators

- ▶ All countries reviewed use CBA in some form and place weights on monetised and non-monetised impacts.
- ▶ Some, like Sweden and UK, base planning and strategy mainly on CBA, others develop strategy and objectives first and use appraisal to value economics and contribution to strategy.
- ▶ Balance placed on CBA and policy merit differ significantly.



- ▶ All retain a significant degree of policy merit. Where assessment frameworks are transparent, the final decision is based on judgment.
- ▶ Also range of approaches to funding allocation – eg Germany has separate envelopes for different levels of government and modes, while Sweden draws on a common funding source.