Office of the Minister of Finance
Office of the Minister of Defence

Chair,
Cabinet Committee on State Sector Reform and Expenditure Control

VOTE DEFENCE FORCE: MID-POINT REBALANCING REVIEW: OPTIONS ANALYSIS

Purpose

This paper considers two alternative funding tracks for the NZDF out to 2029/30. To enable the NZDF to deliver on the expectations set out in the 2010 White Paper, it recommends that Cabinet approve, for planning purposes, annual increases in the NZDF operating allowance

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Executive Summary

2. In the 2010 Defence White Paper the Government set out its defence policy, the tasks we expected the NZDF to undertake in delivering that policy, and the capabilities the NZDF needed to conduct those tasks. The capabilities were set out in the Defence Capability Plan (DCP), approved by Cabinet in August 2011.

3. Extensive analysis has demonstrated that current funding levels cannot deliver the capabilities needed. Even with the full delivery of the NZDF Savings and Redistribution programme, new money is required if the NZDF is to deliver the policy expectations we established in the White Paper.

4. The size of the funding gap was quantified in Phase 1 of a Defence Mid-Point Rebalancing Review (DMRR) commissioned by the Ministers of Finance and Defence. This estimated that the NZDF's net operating costs would grow above the existing baseline by about $77 million per annum from 2015/16; and that capital injections of up to $4 billion would be required by 2029/30. Accordingly, in December 2012 Cabinet directed that Defence examine different force structures and military capabilities than those in the DCP, using a range of alternative funding tracks, as a way of developing options for managing this imbalance [CAB Min (13) 4/3 refers].

5. Indicative options were submitted for Cabinet's consideration in August. In line with Cabinet's direction, six different funding tracks for the NZDF out to 2029/30, and the capabilities that could be funded under each track, were examined.

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6. Cabinet agreed to short-list two tracks, 1 and 3, for further detailed analysis and costing, and asked that another track, Track 4, be carried forward in more detail to demonstrate the funding level at which point a major defence capability is lost. [CAB Min (13) 29/12 refers].

7. The capabilities possible under Tracks 1 and 3 are set out in Annex A. Annex B explains the difference between them. In summary, only Track 1 would enable realisation of the policy outlined in the Defence White Paper. While both tracks retain the NZDF's current combat and resource and border protection capabilities, under Track 3 there is a reduction in enabling capabilities, and thus the ability to act independently or in a lead role within the region.

8. The two tracks also imply different personnel numbers for the NZDF (see Annex C). Track 3 involves fewer personnel because of the loss of capabilities under that Track. Analysis has confirmed the Defence White Paper 2010 assessment that the planned force structure would require some reconfiguration

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9. The funding track approved by Cabinet will be the basis for NZDF funding out to 2029/30. Both Tracks 1 and 3 would result in cumulative increases to the NZDF's operating baseline.

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10. The funding track approved by Cabinet will set the indicative Budget allocations for Vote Defence Force from 2014/15, with an associated impact on the operating allowance. The new funding in each year would be sought by the NZDF in the Vote Defence Force 2014/15 Four Year Budget Plan, as outlined in the table below.

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[1] The forecast operating expenditure for Track 1 in the next four years is projected to be above the total amount covered by the increase in operating allowance.

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11. The DMRR identified that to meet the policy expectations of the White Paper the NZDF would need capital injections s9(2)(f)(iv) . These are outlined in the table below. Current policy is that all new capital expenditure between now and 2016/17 should be drawn from the Future Investment Fund (FIF).

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12. This paper recommends that Cabinet approve, for planning purposes Track 1 as the indicative level of operating funding for the NZDF out to 2029/30.

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While Track 1 delivers a substantial increase in NZDF funding over current baselines (over the forecast period), it is the level of funding that allows the NZDF to maintain the current mix of capabilities outlined in the Defence Capability Plan, allowing it to meet the policy expectations outlined in the White Paper.

Background

13. The Defence White Paper 2010 outlined the Government's defence policy and the roles and tasks the NZDF would be expected to undertake in delivering that policy. Given New Zealand's security interests and the strategic outlook, the White Paper noted that the principal tasks for the NZDF over the next 25 years (out to 2035) would remain much as they were at present, but potentially with intensified demands.

14. The White Paper also outlined the force structure and equipment the NZDF needed to conduct its principal tasks. It envisaged retaining, and in some cases enhancing, the NZDF's "current mix of capabilities, enabling it to operate in places similar to where it is today, alongside current partners and friends".[2] These capabilities were set out in the 2011 Defence Capability Plan. Both the White Paper and the Capability Plan implied increases in both operating and capital funding over a 25 year period. To improve the affordability of those capabilities, the White Paper required that by 2014/15 the NZDF would free up $350 million, on an annual recurring basis, to be re-distributed to front line capabilities (the Savings and Redistribution Programme). However, as the White Paper noted, the full delivery of the programme "will not remove the need for the Government still to contribute new money over time."[3]

[2] Defence White Paper 2010, p.12.

[3] Defence White Paper 2010, p.77

15. In 2012, the first phase of the DMRR quantified the amount of new money needed to deliver the people and equipment specified in the Defence Capability Plan. It found that even if the NZDF fully delivered on its savings target, net operating costs would grow from the existing baseline by $537 million, or about $77 million per annum, from 2015/16 to 2021/22, and there would be a requirement for capital injections of up to $4 billion by 2029/30.

16. In December 2012, Cabinet directed Joint Ministers to identify options to address this funding imbalance [CAB Min (12) 44/15 refers]. Terms of Reference approved by Cabinet in February specified that the analysis examine different force structures and military capabilities than those contained in the Defence Capability Plan, using a range of alternative funding tracks [CAB Min 13 (4/3) refers].

17. In August, Cabinet considered six alternative funding tracks for the NZDF out to 2029/30, as well as the indicative force structures that could be funded under each scenario. The funding tracks reflected a range of possible spending trajectories for the period to 2029/30,

s9(2)(f)(iv)

18. Cabinet short-listed Tracks 1 and 3 for further detailed analysis and refined costing.[4] They consist of:

s9(2)(f)(iv)

b.

19. Additionally, Ministers directed that Track 4 s9(2)(f)(iv) be developed in more detail to demonstrate the impact on the NZDF's capabilities of a reduced Defence budget [CAB Min (13) 29/12 refers]. This is demonstrated in Annex A. Track 4 would require the disposal of the Naval Combat Force, HMNZS *Endeavour*, HMNZS *Manawanui*, and the B757s, as well as significantly reduced Land Combat and Special Forces capabilities.

Recommended funding track – Track 1

20. This paper recommends that Cabinet approve, for planning purposes, Track 1 as the indicative level of funding for the NZDF out to 2029/30.

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[4] The funding tracks represent a fixed amount of money in each Budget. For ease of description, they are referred to as a percentage of forecast GDP.

s9(2)(f)(iv) The forecast operating and capital requirements are set out in paragraphs 36 and 37 below.

21. Track 1 is a level of funding that provides certainty to this and to future Governments that there will be sufficient flexibility to respond to, and manage, future security challenges (including some ability to adapt to changes in the strategic environment), to meet the intensified demands forecast in the Defence White Paper, and to meet the expectations of our major security partners but especially Australia. Track 1 also provides future Governments with flexibility to manage the uncertainties inherent in projecting the affordability (and costs) of military capabilities out to 2029/30.

22. Annex A outlines the indicative capabilities affordable under Track 1. In summary, the NZDF could afford to maintain the current level of capability, while having some flexibility to respond to future changes in the strategic environment. Provision is made for replacing the current frigate fleet in the late 2020s with an equivalent capability, as well as replacing HMNZS *Endeavour* (with a more capable projection and sustainment capability), and the P-3K2 Orions. Track 1 would also permit investments in land forces, including transport, weapons, communications, and Special Forces. Provisioning has also been made under Track 1 to allow the NZDF to undertake a review of strategic airlift requirements, and provide choices to Ministers on the optimal mix of airframes to replace the B757 and C-130 fleet in the future. These investments would maintain, and in some areas enhance, the current mix of capabilities.

23. Track 1 would enable a coherent Defence Force with a range of capabilities that would enable it to undertake the tasks set out in the Defence White Paper, and to lead an independent operation similar in size to the New Zealand contribution to Timor-Leste in 1999, as well as make concurrent maritime and/or air contributions to international security operations (for example a maritime interdiction operation in the Middle East).

Personnel

24. Management of the workforce is critical to the future capability of the Defence Force, against the backdrop of a long-term decline in personnel numbers.

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Improving the affordability of Track 1

26. Since August, to make the proposed capabilities under Track 1 (and Track 3) more affordable, Defence has examined personnel numbers, maintenance of the Defence Estate, and the amount provisioned for new capabilities in the Defence Capital

27. s9(2)(f)(iv)

28.

s6(a) and s9(2)(f)(iv)

Alternative funding: Track 3

29. The indicative capabilities under Track 3 represents the most coherent force that can be delivered at that funding level. While the NZDF would retain all of its major combat capabilities under Track 3, removing the support and enabling capabilities provided in the B757s, Maritime Projection and Sustainment Capability, and Littoral Operations Support Capability, shifts the NZDF away from the type of force envisaged in the Defence White Paper, and the policy intent of being able to operate independently within the region.[7] This means that the NZDF would be able to undertake most of the tasks set out in the Defence White Paper, but would rely on partners when deployed in the region, and further afield, for some support.

30.

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[7] Under Track 3 the NZDF would be required to immediately dispose of HMNZS *Endeavour* (tanker), HMNZS *Manawanui* (Dive support, littoral operations and mine-countermeasures), and the two Boeing 757s in order to preserve other military capabilities that are more highly valued. Annex A provides more detail of the mix of capabilities affordable under Track 3.

31. s9(2)(f)(iv)

Costs within Track 3 have been reduced through reducing personnel, capital and estate provisions as per Track 1, however operating costs have increased in other areas. To deliver the indicative capabilities in Track 3, the forecast operating and capital requirements for the NZDF are set out in paragraphs 36 and 37 below.

Comparison between Track 1 and 3

32. The similarities and differences between Tracks 1 and 3 in terms of the consequential impact on the NZDF's ability to deliver on its outputs are outlined in Annex B. In summary, under Track 1 the NZDF has a coherent set of capabilities, and a range of capabilities that allow it to operate effectively as an independent force within the region. In comparison, under Track 3, there is less coherence due to the removal of projection, replenishment and supply capabilities. The disposal of these capabilities, in order to maintain more highly valued combat capabilities, limits the tasks that the NZDF is able to undertake, and its ability to operate independently within the region.

33. s6(a) and s9(2)(f)(iv)

34. The differences between Tracks 1 and 3 in terms of the NZDF's ability to undertake the tasks, and sub-tasks, outlined in the Defence White Paper 2010 is reflected in Annex D. Under Track 1 the NZDF is able to maintain the current level of output across Defence policy, and with greater availability, reliability and reduced risk than Track 3. Under Track 3 the NZDF would not maintain its ability to operate independently within the region, and would require greater assistance to project, and sustain its forces. Annex F outlines the capabilities (and associated OPEX and CAPEX) that are provisioned for under Tracks 1 and 3, in comparison with Track 4.

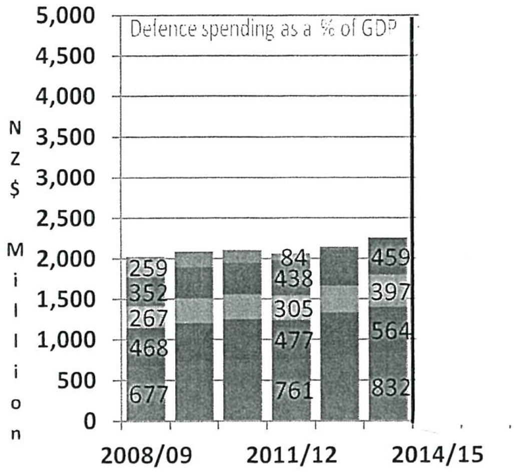
NZDF Cost Drivers

35. s9(2)(f)(iv)

36. The most material increases over the forecast period are increases in the Capital Charge and Depreciation. In the first four years of the forecast period increases in Capital Charge and Depreciation are due to previous capability decisions. The

NZDF's forecast operating expenditure under Tracks 1 and 3 are outlined in the graphs below.[8]

Track 1: NZDF Operating Expenditure[9]



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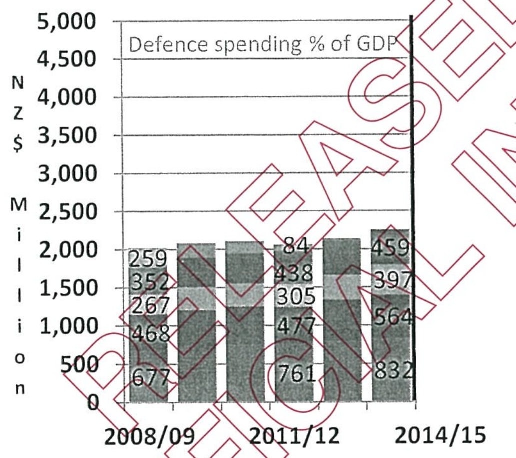
Track 3: NZDF Operating Expenditure



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[8] The bar graphs show a breakdown of the major OPEX costs in real (today) dollars to allow a comparison over time. Inflation in nominal (future) dollars is added at the top of each bar to illustrate the total cost of the NZDF as a nominal figure. This total cost can be compared directly with the funding track, also expressed in nominal dollars.

[9] s9(2)(f)(iv)

37. In order to maintain the NZDF's current capabilities, capital provisions have been made under both Tracks for replacements of a range of platforms during the forecast period. In order to fund these replacements, in addition to the capital that can be funded from accumulated depreciation, the NZDF is forecast to need capital injections. The forecast capital plans for both Tracks, and the indicative injections required to deliver the capabilities, are outlined in the graphs below.

Track 1: Defence Capital Plan: CAPEX Injections Required

s9(2)(f)(iv)

Track 3: Defence Capital Plan: CAPEX Injections Required

s9(2)(f)(iv)

Cost Fidelity and Assumptions

38. There are inherent uncertainties in projecting the cost of military capabilities out to 2029/30. The cost modelling process has indicated that the capital expenditure uncertainty for the period out to 2017/18, and beyond that out to 2029/30, is in the order of plus, or minus, 10 per cent. A large component of this uncertainty is due to foreign exchange uncertainty.

39. Defence has undertaken Quantitative Risk Assurance (QRA) modelling of the capital expenditure associated with Tracks 1 and 3. The modelling showed that the projected costs of both tracks are the best estimate of the median costs over the forecast period. This means that there is a 50 per cent probability that the indicative capabilities presented under Tracks 1 and 3 for DMRR are affordable in any 4 years, over the forecast period. Defence will work to ensure that the capital requirements for the portfolio of projects do not exceed the total quantum over the next four years.

40. The amount of capital required to deliver the indicative capabilities will be subject to individual business cases for major acquisitions.

Fiscal Implications of Tracks 1 and 3

41. The funding track approved by Cabinet in this paper will be used as the basis, for planning purposes, for the NZDF's funding path to 2029/30. Tracks 1 and 3 both result in real growth in NZDF expenditure and a cumulative increase to the NZDF's operating baselines.

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The impact will be managed within Budget operating allowances. The table below outlines the increase to operating and capital allowances associated with Tracks 1 and 3.

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42. The funding track approved by Cabinet will also set the indicative Budget allocations for Vote Defence Force from 2014/15, with an associated impact on the operating allowance. The new funding in each year will be sought by the NZDF in the Vote Defence Force 2014/15 Four Year Budget Plan, as outlined in the table below.

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43. Tracks 1 and 3 will both require new capital over the next four years. Current policy is that all new capital expenditure between now and Budget 2016 be funded from the balance sheet. The primary funding mechanism is the Future Investment Fund (FIF).

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44.

The capital requirements associated with Tracks 1 and 3 over the next four years are outlined in the table below.

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45. Outside a four year period, the assumptions around the timing and scope of capital expenditure become more difficult to make with any confidence.

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DMRR and subsequent budget process

46. The funding track approved by Cabinet will set the indicative Budget allocations for Vote Defence Force for the next four years. Indicative allocations signal that an agency can undertake their strategic planning on the premise that they are likely to receive a certain level of new funding. However, indicative allocations do not guarantee new funding and the NZDF will still be required to demonstrate through their Four Year Plan (4YP) how additional funding would support their strategic direction and the Government's priorities. NZDF will therefore need to include a Budget initiative for 2014 in their 4YP and signal the anticipated outyear funding requests.

Operating expenditure

47. In Budget 2014, the NZDF's baselines for the 2014/15 financial year will be confirmed, along with forecast baselines over a four-year horizon (to 2017/18). This process will continue each year and will allow NZDF and the Treasury to also understand if any operating expenditure is not required. If policy is reviewed (for example there is a new Defence White Paper in 2015), Ministers can re-examine the NZDF's funding track to ensure that there continues to be an optimal balance between defence policy, capability and funding. Work to inform the next White Paper will commence early in 2014.

48. The operating funding sought by NZDF in Budget 2014 is likely to differ slightly from that indicated in this paper. The projected Budget initiatives in this paper are based on the NZDF's baselines at the time of the Budget Economic and Fiscal Update, whereas the NZDF's 4YP will be based on the October Baseline Update.

Capital expenditure

49. Any capital expenditure until 2016/17 will be drawn from the FIF. Capital injections will also need to be sought through the NZDF's 4YP and proposals will be assessed through the Budget process each year. A decision is yet to be made on the process for capital allocation once the FIF is exhausted. The funding tracks will be used in business cases to demonstrate affordability, however future Governments will still need to determine the affordability of individual projects on a case by case basis in the context of the Capital Asset Management Regime. Cabinet will be presented with a detailed business case for each significant capital acquisition provisioned for within the selected track, before it is finally approved. Capital allocations will also be subject to annual review through the 4YP process.

DMRR and the Savings and Redistribution Programme

50. The DMRR builds the future costs of the NZDF from the bottom up – this includes incorporating the initiatives and savings achieved to date through the Savings and Redistribution Programme ($204m annually on a recurring basis).

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51. In order to deliver the indicative capabilities in Track 1 a further commitment to ongoing savings and continuous improvement initiatives will be required in order to make those capabilities more affordable over time. Following on from the Savings and Redistribution Programme, NZDF is well placed to identify the next continuous improvement goals. As part of the submission of the 4YP in January 2014, Defence in consultation with the Treasury will present Joint Ministers with the planned continuous improvement initiatives for the coming financial year, for Joint Ministers' endorsement. NZDF will then report to Joint Ministers on progress on those initiatives annually, or more frequently if required, and propose the next year's priorities.

Next Steps: Post DMRR work streams

52. In order for the NZDF to deliver on its agreed funding stream, achieve ongoing organisational efficiencies, and maintain an ongoing balance between defence policy, capability and funding, Defence will commence a series of work streams post-DMRR. The scope and indicative timeframe for this work is outlined in Annex G. This work includes a revised Defence Capability Plan and Capital Plan aligned to the selected funding track; a Output Review; an analysis of options for improving cost management, benefit realisation and schedule performance for defence capability projects; a personnel review; work on the Defence Estate; and work to inform the next Defence White Paper (notionally scheduled for 2015).

Financial Implications

53.

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55.

Consultation

56. This paper reflects the views of the New Zealand Defence Force, Ministry of Defence and Treasury.

57. The following agencies have been consulted: State Services Commission, Ministry of Foreign Affairs and Trade, New Zealand Police, New Zealand Security Intelligence Service, Ministry of Health, Ministry of Civil Defence and Emergency Management, New Zealand Customs Service, Ministry of Primary Industries, National Maritime Coordination Centre, Ministry of Business, Innovation and Employment, Government Communications Security Bureau, Department of Conservation and Maritime New Zealand. The Department of the Prime Minister and Cabinet has been informed.

58.

s6(a)

> Furthermore, MFAT supports funding Track 1 to maintain New Zealand's ability to respond to humanitarian and disaster relief (HADR) efforts in the region, as the corollary of a reduction in NZDF's support capabilities would be an equivalent reduction in New Zealand's HADR capacity."

Legislative, Human Rights and Gender Implications

59. There are no legislative, human rights or gender implications.

Publicity

60. The Minister of Defence will make a statement on the outcome of the DMRR in an appropriate setting.

Recommendations

61. We recommend that the Committee:

Background

1. **note** that the Defence White Paper 2010, which established the current policy and military capability requirements for the New Zealand Defence Force (NZDF), forecast the need for, but did not include, the provision of any additional funding for the NZDF;

2. **note** that the first phase of the Defence Mid-Point Rebalancing Review (DMRR), found that even if the NZDF Savings and Redistribution Programme fully delivered on its savings target of $350 million annually, net operating costs would grow from existing baseline by $537 million (or about $77 million per annum) from 2015/16 to 2021/22, and there would be a requirement for capital injections of up to $4 billion by 2029/30;

3. **note** that in February 2013, the Cabinet Committee for State Sector Reform and Expenditure Control (SEC) approved the Terms of Reference for the next phase of the DMRR, and authorised the Minister of Finance and the Minister of Defence (Joint Ministers) to approve the detail of the funding tracks that would act as guidelines for the scope of options to be examined;

4. **note** that Joint Ministers approved in March six funding tracks out to 2029/30

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5. **note** that in August Cabinet shortlisted two potential funding tracks for more detailed analysis and refined costing:

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6. **note** that Cabinet also directed that Track 4 be developed in more detail to demonstrate the funding level at which point a major defence capability is lost;

Recommended Funding Track – Track 1

7. **note** that under Track 1 the NZDF would retain (and be able to replace at end of life) its current combat and resource and border protection capabilities, and that it would be able to lead an operation in the region and/or operate without needing to rely on others, as well as make concurrent contributions to international security;

8. **note** that under Track 1 the NZDF is able to maintain the current level of output across Defence policy, but with greater availability, reliability and reduced risk than Track 3.

9.

s6(a) and s9(2)(f)(iv)

10.

11. s9(2)(f)(iv)

12. **agree** that Track 1 should be used as the basis for planning purposes as the level of NZDF Operating and Capital funding out to 2029/30;

13. **agree** that Track 1 Operating and Capital funding for the next 4 years be the basis for the Vote Defence Force 4 Year Budget Plan, including for Budget 14;

14. **agree** to the following indicative funding increases to the NZDF's operating baselines from 2014/15 to 2017/18 to be used as the basis for the 2014 Vote Defence Force 4-Year Plan;

s9(2)(f)(iv)

15. **agree** to the following indicative Budget allocations for the NZDF from 2014/15 to 2017/18 from the Future Investment Fund for Capital Injections to be used as the basis for the 2014 Vote Defence Force 4-Year Plan;

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16. **agree** that Defence will ensure that the capital requirements for the portfolio of projects do not exceed the total quantum of capital injections shown in the table above over the next four years;

17. **note** that the funding sought by the NZDF in Budget 2014 will be updated and finalised in the NZDF's Four Year Plan following the October Baseline Update;

Alternative Funding Track – Track 3

18. s9(2)(f)(iv)

19. **note** that under Track 3 the NZDF would be able to retain its combat and resource and border protection capabilities, but with a reduction in enabling capabilities, and hence the ability to act independently or in a lead role within the region;

20. **note** that under Track 3, the funding available would require the immediate disposal of the sustainment and projection capabilities HMNZS' *Endeavour*

(Tanker) and *Manawanui* (Dive support, littoral operations and mine countermeasures), and the two Boeing 757s in order to preserve other more highly valued military capabilities;

Impact of less funding under Tracks 1 and 3

21. **note** that reducing the funding below Track 1 would require the NZDF to remove one or more of the capabilities provisioned for under Track 1, but not Track 3 – i.e. the B757s, the Maritime Projection and Sustainment Capability or the Littoral Support Capability - in order to preserve other more highly valued military capabilities;

22. **note** that reducing the funding below the amount required to deliver the indicative capabilities in Track 3 would require the NZDF to remove one of the two major capabilities that are provisioned for under Track 3 – either the size of the Land Combat Force or the Naval Combat Force – that is not able to be retained at a lower level of funding, in order to preserve other more highly valued military capabilities;

23. **note** that removing either of those major capabilities from Track 3 would significantly decrease the ability of the NZDF to undertake the principal tasks outlined in the Defence White Paper;

DMRR and subsequent budget process

24. **note** the NZDF Four Year Plan will be based on the indicative Budget allocations over four years and include annual capital and operating Budget initiatives;

25. **note** that the Four Year Planning process will provide an annual opportunity to review the operating and capital expenditure requirements of the NZDF;

26. **note** that Ministers may wish to re-examine funding when defence policy is reviewed to ensure policy and funding remain aligned;

Post DMRR work streams

27. **note** that as part of the submission of the Four-Year Plan in January 2014, Defence, in consultation with the Treasury, will present Joint Ministers with the planned continuous improvement initiatives for the coming financial year;

28. **direct** that in order for the NZDF to deliver on its agreed funding stream, achieve ongoing organisational efficiencies, and maintain an ongoing balance between defence policy, capability and funding, Defence, in collaboration with Treasury, the State Services Commission and the Department of the Prime Minister and Cabinet, will commence a series of work streams post-DMRR which includes;

28.1 a revised Defence Capability Plan and Capital Plan aligned to the selected funding trajectory – to be presented to Cabinet before the end of December;

28.2 a Output Review which will provide a new output structure for Defence that takes account of the DMRR outcome – to be presented to Cabinet before the end of December;

28.3 an analysis of options for improving cost management, benefit realisation and schedule performance for Defence capability projects will be presented to Joint Ministers (Finance and Defence) in March 2014;

28.4 a personnel review to examine the positions and ranks provisioned for in DMRR – it is expected that this work will be completed by mid-June 2014;

28.5 work on Defence Estate to finalise the proposed property delivery approach (aligned to the approved track) for submission to Cabinet before the end of 2014;

28.6 work to inform the next Defence White Paper, notionally scheduled for 2015.

HON BILL ENGLISH
Minister of Finance

October 2013

HON Dr JONATHAN COLEMAN
Minister of Defence

October 2013

Annex E: Improving the affordability of Track 1 (and 3)

1. To make the indicative capabilities outlined under Track 1 (and Track 3) more affordable, further detailed costing has been undertaken including examination of personnel numbers, maintenance of the Defence Estate, and the amount provisioned for new capabilities in the Defence Capital Plan.

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s6(a)

Personnel challenges under Track 3.

5. Lower overall personnel numbers under Track 3 (compared with Track 1) would mean that the organisation has less workforce resilience to manage the impact of sustained operations, as there would be fewer people to deploy.

Estate

s9(2)(f)(iv)

6. The NZDF Estate has historically been subject to a lower spend than required to undertake maintenance and replace capital (recapitalisation). As a result much of the NZDF estate is aged, degraded and incurring increasing compliance and capability risks. Provisions have been made under both tracks to replace expiring Defence Estate, including the recapitalisation backlog and undertake necessary seismic replacement by 2025. Under both tracks, Defence would be able to sustain the current Estate footprint, but over time would identify internal efficiencies, reduce risk and ongoing maintenance and be able to consolidate within the existing footprint as buildings are replaced.

7. Analysis of various estate remediation options as part of DMRR has shown that it is less expensive over the long term to remediate the estate by 2025, due to the higher maintenance cost associated with retaining dilapidated infrastructure beyond that period. NZDF proposes to increase recapitalisation provisions to stem further degradation of Defence estate. However, in order to reduce the requirement for capital injections before 2020, the NZDF would propose to complete this work over a longer timeframe. The exceptions to this are largely buildings that do not meet the Building Act requirements for seismic events. Reducing recapitalisation has a consequential impact of increasing operating costs associated with maintenance of dilapidated estate.

8. DMRR has provisioned for ongoing maintenance at 90 per cent of the amount identified as best practice. Meeting the requirements for ongoing maintenance with the amount provisioned, will require Defence to find efficiencies in the way that it manages the estate portfolio. Options for managing investment in estate will be the subject of further detailed analysis and Defence will develop a comprehensive estate investment plan.

Defence Capital Plan

9. The chart below outlines the amount (in terms of percentage) of the capital plan associated with future capability replacements and enhancements. In summary, cent of the future capital spend is associated with 3 major capabilities: the frigate replacement in 2027/28 per cent), C-130 replacement in 2020/21 and P-3K2 Orion replacement in 2023/24 . In addition, Estate consumes s9(2)(f)(iv)

cent, and other major capabilities require per cent. This leaves approximately 17 per cent for other projects.

9(2)(f)(iv)

10. In order to improve the affordability of the Capital Plan, Defence has reduced the size of the capital plan (out to 2029/30) by removing some projects, and reducing the amount provisioned for some projects that make up the 17 per cent of other projects.

s6(a)

Annex F: Capabilities provisioned for under Tracks 1 and 3

s 9(2)(f)(iv)

1. The overall amount of funding required to deliver the indicative capabilities under both tracks is relatively similar over the forecast perioc This difference largely relates to the capabilities provisioned for under Track 1, that are not included in Track 3, as well as different timings around personnel growth.

2. The amount of funding required under Tracks 1 and 3 represent the minimum funding required to support the indicative capabilities for each track. Reducing the funding below the amount required to deliver the indicative capabilities in Track 1 would require Ministers to reconsider one or more of the capabilities provisioned for under Track 1, but not 3, in order to preserve other more highly valued military capabilities. Removing all of these capabilities would affect the ability of the NZDF to operate independently, or in a lead capacity within the region.

3. Reducing the funding below the amount required to deliver the indicative capabilities in Track 3 would require Ministers to reconsider one of the two major capabilities that are provisioned for under Track 3 (either the size of the Land Combat Force or the Naval Combat Force), but not Track 4. Removing either of those major capabilities would significantly decrease the ability of the NZDF to undertake the principal tasks outlined in the Defence White Paper.

Capability	Track 1 provision (OPEX and CAPEX)	Track 3 provision (OPEX and CAPEX)
Maritime Projection and Sustainment Capability	p/a from 2018/19. CAPEX of	No provision
Littoral Operations Support Capability	p/a from 2018/19. CAPEX of	No provision
Boeing 757s (2)	Average p/a for B757. Average p/a from FY 2024/25 for A400. CAPEX of for replacement A400s in 2022/23 and 2023/24.	No provision - Loss of B757 forecasted incurs additional cost of $6m p/a for other fleets
Naval Combat Force (2 Frigates and associated Seasprite Helicopters)	Average p/a to 27/28 growing to p/a once new frigates are fully operating. CAPEX of up to billion to replace the frigates in 2028/29.	Average p/a to 27/28 growing to p/a once new frigates are fully operating. CAPEX of up to to replace the frigates in 2028/29.

s (9)(2)(f)(iv)

800 person sustainable Battalion	p/a and CAPEX of above the amount provisioned in Track 4.	p/a and CAPEX of above the amount provisioned in Track 4.	

Annex G: Post DMRR work streams

Defence Capital and Capability Plans

1. A detailed Defence Capability Plan, and associated Capital Plan aligned to the selected funding trajectory, will be developed for consideration by Cabinet in December. For Track 1 this will maintain the existing mix of capability intentions outlined in the current Defence Capability Plan, reflecting any changes as a result of DMRR and the associated Capital Plan. In the event that Ministers choose Track 3, a new Capability Plan and Capital Plan reflecting a reduced set of capabilities will be required.

Output Review

2. Both Tracks 1 and 3 have used a new output structure as the basis for determining the highest value for money capabilities provided under each Track. This new output structure provides a new outcome focussed framework for Defence to align outputs with Defence policy, and the NZDF's strategy out to 2035. This work will be developed to inform Budget 14, and will propose a new performance management framework and Output structure cognisant of the outcome of DMRR. It is intended that this work will be submitted to SEC before the end of December.

Procurement Assurance

3. In order to provide greater confidence in the delivery of the new Defence Capital Plan, Defence in consultation with Treasury will undertake a review of procurement performance across NZDF and the Ministry of Defence. The review will identify options for improving cost management, benefit realisation and schedule performance for Defence capability projects. Defence will report to Joint Ministers on the review and the options in March 2014.

Personnel Review

4. Defence will undertake a personnel establishment review to examine the positions and ranks provisioned in DMRR. The output of this review will be a refined establishment, aligned to DMRR outcomes, and reflective of the medium-term demand for personnel. This new establishment will inform the demand side of NZDF workforce plans. It is expected that this work will be completed by mid-June.

Defence Estate

5. Post-DMRR, Defence will work with the National Infrastructure Unit (Treasury) and Property Management Centre of Expertise to finalise its proposed property delivery approach for submission to Ministers. This advice to Ministers will be based on feedback from the market engagement exercise undertaken by NZDF in late 2012. This advice will provide a framework, and indicative timings for estate remediation work.

Upcoming Business Cases

6. A number of business cases are currently being developed which will be submitted to Cabinet before June 2014 (depending on the selected funding track). These business cases will allow Ministers to determine the optimal level of investment in the proposed capabilities provisioned for as part of the DMRR exercise, and include:

- Implementation Business Cases (IBC) for: Frigate Systems Upgrade; the Battle Training Facility and the Pilot Training Capability;
- Indicative Business Case for the Littoral Operations Support Capability (Track 1 only);
- Detailed Business Case for the Maritime Projection and Sustainment Capability (Track 1 only); and,
- a Programme Business Case for the Network Enabled Army programme.

Defence White Paper 2015

7. The next Defence White Paper, notionally scheduled for 2015, provides an opportunity to validate the policy settings established by the previous White Paper used as the basis for DMRR. This will provide Ministers with an opportunity to examine the strategic environment in more detail to ensure that the assumptions (and provisions) made in DMRR remain appropriate. The White Paper will also provide the opportunity to provide an update on the post-DMRR work outlined above.