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PUBLIC SECTOR DISCOUNT RATE

Cost benefit analysis is an essential part of the capital asset management (CAM) regime established by Cabinet in December 2007. Its purpose is to improve the quality of capital asset management, and deliver worthwhile value for money gains over time.

The Treasury has for many years used 10% (real) as the discount rate in cost benefit analysis. This discount rate has recently been reviewed. We concluded that a single discount rate does not do justice to the differences that exist between public sector projects with different risk characteristics. Using the capital asset pricing model (CAPM), we concluded that the discount rates should be as follows (note these are real, as opposed to nominal, rates):

Default rate (for projects that are difficult to categorise):	8.0% p.a.
General purpose office and accommodation buildings	6.0% p.a.
Infrastructure and special purpose (single-use) buildings: Water and energy Prisons Hospitals Hospital energy plants Road and other transport projects	8.0% p.a.
Telecommunications, media and technology IT and equipment Knowledge economy (R&D)	9.5% p.a.

These rates are offered by way of guidance. They are particularly appropriate for public sector projects which are of a financial or commercial nature, in other words which are of the kind that could also be carried out by the private sector. Investments in buildings, equipment, financial instruments or infrastructure are all of this type.

However, the above rates may have more general applicability, such as for decisions on the level and type of services or other actions to be provided, or on the extent of regulation with economic/financial implications. We anticipate that they will be appropriate for most public sector expenditure proposals that involve an expectation of benefits in a later time period. Different rates may be adopted in cases where it can be justified on objective opportunity-cost grounds.

Guidance on how to carry out cost benefit analysis is available at <http://www.treasury.govt.nz/publications/guidance/costbenefitanalysis>. An explanation of how the discount rates were arrived at is set out in the technical note <http://www.treasury.govt.nz/publications/guidance/costbenefitanalysis/discountrates>.

Note this guidance does not affect discount rates that are used for valuation and reporting purposes. Guidance on determining discount rates for such purposes is contained in GAAP.

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