

Joint report: Delegated authority for potential further Crown iReX funding

Date:	14 May 2021	Report No:	T2021/1138 (The Treasury) OC210403 (Ministry of Transport)
		File Number:	SE-2-25-2

Action sought

	Action sought	Deadline
Minister of Finance (Hon Grant Robertson)	Agree to undertake Ministerial consultation on the attached Cabinet paper.	17 May 2021
Minister of Transport (Hon Michael Wood)	Agree to undertake Ministerial consultation on the attached Cabinet paper.	17 May 2021
Minister for State Owned Enterprises (Hon Dr David Clark)	Agree to undertake Ministerial consultation on the attached Cabinet paper.	17 May 2021

Contact for telephone discussion (if required)

Name	Position	Telephone	1st Contact
Daniel Madley	Analyst, Commercial Performance, The Treasury	[35]	✓
Michael Moore	Acting Manager, Commercial Performance, The Treasury		
Richard Manning	Senior Advisor, Supply Chain, Ministry of Transport		✓
Harriet Shelton	Policy Manager, Supply Chain, Ministry of Transport		

Actions for the Ministers' office staff

<p>Return the signed report to Treasury and the Ministry of Transport. Following Ministerial consultation, lodge the Cabinet paper with the Cabinet Office by Thursday 27 May 2021.</p>

Note any feedback on the quality of the report

Enclosure: Yes (Attached)

[Letter from Ministers to KiwiRail regarding the iReX project \(Treasury:4458029v1\)](#)

Treasury:4458126v1

Joint report: Delegated authority for potential further Crown iReX funding

Purpose

1. This report recommends that you agree to undertake Ministerial consultation on the Cabinet paper provided as **Annex One**. This Cabinet paper seeks delegated authority to provide up to [37] in further Crown funding, if required, to KiwiRail Holdings Limited (KiwiRail), as it looks to replace its ferry fleet (part of Project iReX).

Background and analysis

KiwiRail is looking to sign a contract for new ferries before 30 June 2021, but new Crown funding will likely be required

2. KiwiRail's existing ferry fleet is reaching the end of its economic life. Under Project iReX, KiwiRail is seeking to procure two new rail-enabled ferries by 2025/26, and is working with port owners to improve infrastructure in Picton and Wellington to accommodate the new, larger ferries.
3. KiwiRail signed a Letter of Intent with Hyundai Mipo Dockyard in South Korea in December 2020. The letter locked in terms and prices for the two ferries while detailed contractual negotiations are undertaken. The letter expires on 30 June 2021; if KiwiRail does not sign a contract by this time, the terms and costs can be renegotiated and are likely to increase, as outlined in paragraph 13 below.
4. At the same time, significant uncertainty remains with landside costs. Negotiations continue with both Port Marlborough and CentrePort over the respective share of costs (and the total costs of landside infrastructure). While there will be costs to KiwiRail from delaying the ship-build contracts, there are also equally important risks associated with committing to the ship-build without certainty regarding landside costs and shares.
5. The total cost of Project iReX is currently forecast to be \$1.45 billion. The Crown has already provided \$435.1 million of funding through Budgets 2019 and 2020. Budget 2020 funding of \$400.1 million was provided with the expectation that KiwiRail would debt finance the remainder of the project, in addition to port contributions. However, an estimated funding gap of \$257 million remains, which KiwiRail is working to reduce. We understand that KiwiRail will seek further Crown funding to bridge this gap.
6. KiwiRail has indicated that it will provide a board approved Detailed Business Case (DBC) to Ministers and officials in early June 2021. This followed a letter on 8 April 2021 from the Minister for State Owned Enterprises declining a drawdown request of \$34.9 million for the project and requesting that KiwiRail prioritise finalisation of the business case, among other matters. For your reference this letter is attached as **Annex Two**.
7. It is highly likely that the estimated funding gap may change when the DBC is submitted. It is also normal for costs to change following DBC approval, once the project has been subject to further detailed design work. It will therefore be important for cost estimates in the DBC to be expressed as a range. KiwiRail's Board will require Ministers to commit to further funding, thus 'bridging' the funding gap, before it has the confidence to enter into a contract with the shipyards.

We recommend that you seek delegated authority from Cabinet to approve up to [37] in further Crown funding for Project iReX, if required

8. We advise that our assessment of any further Crown funding towards Project iReX will not be possible before the DBC is received in early June 2021. Given Cabinet consultation timeframes, and KiwiRail's preferred deadline for Ministers to respond by 30 June 2021, it would not be possible for officials to fully assess the business case, provide you with advice, and for you to receive Cabinet approval for further Crown funding, which will likely be required, before 30 June 2021.

9. Seeking delegated authority from Cabinet to provide further iReX funding, if required, removes a large amount of risk from this timeframe. By moving the Cabinet timeframe forward, it increases the likelihood of you being able to respond to the DBC by 30 June 2021, to mitigate the risks outlined in paragraphs 12 to 14 below.
10. A draft Cabinet paper is provided as **Annex One**. The paper seeks agreement from Cabinet to establish a tagged capital contingency for Project iReX of up to [37] with delegated authority to you (as joint Ministers) to jointly draw down the contingency, if required, subject to your satisfaction with KiwiRail's DBC and that the risks and trade-offs of contracting for the ferries can be mitigated and are otherwise acceptable.
11. KiwiRail is considering several options, including the ability to increase its debt borrowing, to decrease the funding gap from \$257 million. We advise that delegated authority should still be sought for up to [37], in order to provide a contingency should costs increase.

Risks

12. The main risk, if Cabinet does not agree to delegated authority, is that Ministers are far less likely to be able to respond to KiwiRail's DBC with a commitment for further Crown funding, if required, by 30 June 2021. KiwiRail is considering seeking an extension of several weeks on the Letter. However, we understand you would like to ensure that Ministers are best placed to respond by 30 June 2021, in the event that no extension is forthcoming.
13. KiwiRail, and by extension the Crown, will be exposed to risks if the contract for new ferries is not signed by 30 June 2021, as the terms of the contract will be able to be renegotiated. These risks include:
 - a. The build slot for the new ferries may be deferred, which would require an extension of the working life of the existing ferries. KiwiRail has advised that this would result in annual maintenance costs of [37] per annum from 2025. Given the age of the existing ferries, there is also a risk that an older ferry could lose its compliance certificate to carry passengers, and could only carry freight. This would reduce KiwiRail's return on its passenger service by an estimated [37] per annum. KiwiRail would consider leasing a ship at an estimated [37] per annum to maintain services and market share.
 - b. The cost of the ship build could increase by approximately [37] [38]. KiwiRail notes that the price of steel plate commodities has increased 50 per cent since December 2021. The shipyard would likely look to pass on these increased costs during any contract renegotiation.
14. [34] There are also potential implications for the National Land Transport Fund (NLTF) in terms of funding road and rail connections. The NLTF is already under significant pressure and this will need to be considered when the final DBC is received.

Next steps

15. If you agree with the draft Cabinet paper, we recommend that you undertake Ministerial consultation on the paper, with the intention for the paper to be considered by the Cabinet Economic Development Committee on 2 June 2021.
16. The timeframe between receiving the DBC in early June 2021, and Ministers responding to the DBC in late June 2021 remains tight. The anticipated broader timeframe for this work is outlined in the table below.

TIMEFRAME	ACTION
Monday 17 May – Wednesday 26 May	Undertake Ministerial consultation on Cabinet paper
Wednesday 2 June	Cabinet Economic Development Committee
Wednesday 2 June	KiwiRail Board meeting to approve the Detailed Business Case
Friday 4 June	Anticipated date that documents will be supplied to Ministers and officials
Tuesday 8 June	Cabinet consideration of Cabinet paper
Wednesday 9 June	Minister of Finance, Minister of Transport, and Minister for State Owned Enterprises scheduled to meet with KiwiRail to discuss the Detailed Business Case
Monday 21 June	Officials will provide advice to Ministers
Tuesday 22 June – Monday 28 June	Ministers can consider advice, and advise KiwiRail of response

Recommended action

We recommend that you **agree** to undertake Ministerial consultation on the draft Cabinet paper provided as Annex One, with a view to lodging the paper to be considered at the Cabinet Economic Development Committee on 2 June 2021.

Agree/disagree.
Minister of Finance

Agree/disagree.
Minister of Transport

Agree/disagree.
Minister for State Owned Enterprises

Michael Moore
**Acting Manager, Commercial Performance,
The Treasury**

Harriet Shelton
**Policy Manager, Supply Chain,
Ministry of Transport**

Hon Grant Robertson
Minister of Finance

Hon Michael Wood
Minister of Transport

Hon Dr David Clark
Minister for State Owned Enterprises

Hon Dr David Clark

MP for Dunedin

Minister of Commerce and Consumer Affairs
Minister for the Digital Economy and Communications
Minister for State Owned Enterprises
Minister of Statistics
Minister Responsible for the Earthquake Commission



08 APR 2021

Brian Corban
Chair, KiwiRail Holdings Ltd
[23]

Dear Brian

I am writing to you on behalf of shareholding Ministers and the Minister of Transport regarding the iReX Programme.

The Minister of Finance has received your budget bid for the iReX programme, and we are aware that you have tabled a subsequent scaling option for the bid. The bid will be processed and considered alongside other bids in the Budget 2021 process.

While we acknowledge its importance to New Zealand's resilience and transport outcomes, the iReX project is one which continues to cause Ministers concern as there remains considerable uncertainty over scope, costs and funding options. A final detailed business case has yet to be presented to shareholding Ministers.

The Minister for State Owned Enterprises wrote to you in October 2020 outlining expectations around consultation and improved information flows. I also note that Cabinet directed KiwiRail in May 2020 to provide regular reporting to the Minister for State Owned Enterprises, Minister of Finance and the Minister of Transport on progress of the ferry replacement project, including a full breakdown of financial performance and the impact of additional debt on KiwiRail and ability to repay that debt.

We would like to reinforce the need for more transparent information around the proposed project, options available regarding scope and funding, and reassurances around the management of risks.

In particular, we ask that you:

- Prioritise the finalisation, including Board sign-off, of the final detailed business case and submit to our officials for review.
- Advise of the feasibility of reverting to a less capital-intensive option, such as two medium sized ferries, which represented a similar NPV to your preferred option when assessed in December 2018 under pre-COVID-19 conditions.
- Provide further information around the extent to which costs can be met by the ports and their ownership Councils, including whether other parties are supportive and have the financial commitments required.
- Advise what further work you have planned to test your ability to take on more debt funding in relation to the project. I note that we are looking for KiwiRail to debt fund as much of this project as possible to ensure the commerciality of the project.

- Confirm that you have fully considered the whole of life costs of the project, including all land-side costs, and costs that will be met by parties other than KiwiRail. This should include the costs of reconfiguring road and rail networks that connect to the ferry terminals.

Given this request for further information, shareholding Ministers have decided, at this time, to decline KiwiRail's request for a drawdown of \$34.9 million in iReX funding.

We acknowledge that this is a challenging project and appreciate the effort of the Board and staff of KiwiRail on the iReX programme. We look forward to your responses to the above matters.

Yours sincerely

Hon Dr David Clark
Minister for State Owned Enterprises

cc Hon Grant Robertson, Minister of Finance
Hon Michael Wood, Minister of Transport
Greg Miller, Group Chief Executive, KiwiRail Holdings Ltd