

OC230428

14 June 2023

Tēnā koe 

I refer to your email dated 15 May 2023, requesting the following under the Official Information Act 1982 (the Act):

“The Chatham Islands Enterprise Trust have been working with the Ministry of Transport for the last 12 months to progress the Chatham Island shipping replacement project. Funding of \$35.1 million was secured in Budget 2022 for this project (funding letter attached).

Funding was contingent on approval from Ministers of Transport, Finance and Internal Affairs on vessel ownership, governance and operating model. A Ministry of Transport briefing was submitted to Ministers in March 2023 addressing these contingencies. On 12/04/23 we were notified by James O’Donnell that the Minister of Finance did not approve the proposed operating model.

We, the Chatham Islands Enterprise Trust (CIET), through our Shipping Project Committee (SPC) have continued to work with Hayden Berkers from MOT to offer any assistance we can to address ministerial concerns. We have been advised by Hayden that a second briefing paper has now gone to the three Ministers, and this addresses both the proposed operating model and a proposal to transfer the project to Waka Kotahi.

This OIA request is for copies of both these briefing papers submitted to the ministers on this project. I have attached our most recent letter to Ministers which outlines our concerns and reasons for this request.”

Two documents fall within the scope of your request and are detailed in the document schedule attached as Annex 1. The schedule outlines how the documents you requested have been treated under the Act.

Certain information is withheld under the following sections of the Act:

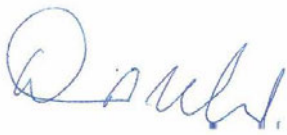
- | | |
|-------------|--|
| 9(2)(a) | to protect the privacy of natural persons |
| 9(2)(f)(iv) | to maintain the constitutional conventions for the time being which protect the confidentiality of advice tendered by Ministers of the Crown and officials |

Information has been withheld under section 9(2)(f)(iv) while decisions from Ministers are sought. The Ministry will provide you with further information when decisions have been confirmed, including the briefing OC220467.

You have the right to seek an investigation and review of this response by the Ombudsman, in accordance with section 28(3) of the Act. The relevant details can be found on the Ombudsman's website www.ombudsman.parliament.nz

The Ministry publishes our Official Information Act responses and the information contained in our reply to you may be published on the Ministry website. Before publishing we will remove any personal or identifiable information.

Nāku noa, nā

A handwritten signature in blue ink, appearing to read 'David Wood', is positioned above the printed name.

David Wood
Deputy Chief Executive

Annex 1 - Document Schedule

Table 1 Annex One - Document Schedule

Doc #	Date	Document	Decision on release
1	31 March 2023	OC220467 - Chatham Islands Ship Replacement: Authorisation to access contingency funding for vessel purchase	Withheld in full under section 9(2)(f)(iv) of the Act.
2	8 May 2023	OC230384 - Progressing the Chatham Islands vessel replacement project	Enclosed. Some information withheld under section 9(2)(a) and 9(2)(f)(iv).



8 May 2023

OC230384

Hon Grant Robertson

Action required by:

Minister of Finance

Monday, 15 May 2023

Hon Barbara Edmonds

Minister of Internal Affairs

Hon Kiri Allan

Associate Minister of Transport

CC: Hon Michael Wood

Minister of Transport

PROGRESSING THE CHATHAM ISLANDS VESSEL REPLACEMENT PROJECT

Purpose

The purpose of this briefing is to provide further context, information, and assessment of the proposed operating model for the Chatham Islands vessel replacement project. s 9(2)(f)(iv)

[Redacted]

Key points

- As part of Budget 2022, Cabinet approved \$35.1 million in contingency funding to support the Chatham Islands to replace its current vessel, the *Southern Tiare*, and to support its maintenance until a replacement vessel is delivered.
- \$6 million of contingency funding was released in July 2022 to support the maintenance of the *Southern Tiare*. The remaining Budget funding of \$29.1 million that is allocated has a number of conditions, including determining the business operating model, ownership model and governance arrangements for the future shipping solution.

- s 9(2)(f)(iv) [Redacted]

[Redacted]

s 9(2)(f)(iv)

- The proposed operating model prepared by an external consultant outlines a 25-year forecast based on a range of assumptions. The basis for the model is detailed information from the current shipping operation. Overall, the service is projected to be cash-flow positive until around year 7 to 8, after which it is forecast to have a cash-flow deficit.
- Small changes to the assumptions within the model lead to significant changes in the longer-term financial projections. In particular, the operating model is based on a higher level of cost growth compared to revenue over the full term of the model (revenue is forecast to grow in line with CPI inflation rather than with costs, which are assumed to grow at a higher rate than inflation).
- There are options that the operator of the vessel could take, which are not included within the financial projections, s 9(2)(f)(iv). These options include increasing the charges to meet cost increases rather than just CPI inflation, and seeking alternative revenue sources.
- Engagement with the Chatham Islands has outlined that these options are expected and able to be implemented if there are financial sustainability concerns. These options are normal practice for the Chatham Islands. It is a clear expectation of the Chatham Islands that funding is not available for on-going operational costs.
- As such, the Ministry of Transport considers that the short and medium-term operations of the ship are expected to be manageable and reach financial sustainability. s 9(2)(f)(iv)
- The Chatham Islands Enterprise Trust has written to Ministers to seek confirmation of the project status and voice concerns that the project is being delayed. On the basis that the further context and assessment of the proposed operating model is suitable, we recommended that Ministers agree for communications to be provided from the Associate Minister of Transport to the Chatham Islands confirming the vessel replacement project is progressing.

Recommendations


We recommend you:

- 1 **note** s 9(2)(f)(iv) [redacted] Yes / No
 [redacted]
 [redacted] The
 Ministry of Transport expects that the short and medium term operation of the vessel will be financially sustainable.
- 2 **note** that the Chairperson of the Chatham Islands Enterprise Trust has written to Ministers seeking confirmation of the project's delivery and voicing concerns that the project is being delayed and has not progressed to the delivery phase Yes / No
- 3 **agree** that correspondence can be provided from the Associate Minister of Transport to the Chatham Islands community confirming the vessel replacement project is progressing Yes / No

Hon Grant Robertson
Minister of Finance
 / /

Hon Barbara Edmonds
Minister of Internal Affairs
 / /

Hon Kiri Allan
Associate Minister of Transport
 / /


 Richard Cross
Director, System Performance and Governance
 8 / May / 2023

THE OFFICIAL INFORMATION ACT 1982

- Minister's office to complete:**
- Approved
 - Declined
 - Seen by Minister
 - Not seen by Minister
 - Overtaken by events

Comments

Contacts

Name	Telephone	First contact
Richard Cross, Director, System Performance and Governance	s 9(2)(a)	
Hayden Berkers, Principal Advisor, Programme Assurance and Commercial		✓

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PROGRESSING THE CHATHAM ISLANDS VESSEL REPLACEMENT PROJECT

Background

s 9(2)(f)(iv) [Redacted]

- 1 As part of Budget 2022, Cabinet approved \$35.1 million in tagged contingency funding to support the Chatham Islands to replace the *Southern Tiare*, and to support its maintenance until a replacement vessel is delivered.
- 2 In July 2022, Ministers agreed to draw down \$6 million of the \$35.1 million contingency funding to allow the *Southern Tiare* to receive its required maintenance (OC220467 refers). This funding was approved and the maintenance is about to commence. This will confirm that the vessel and equipment are sound and seaworthy, and meet all applicable maritime and marine protection rules.
- 3 The remaining \$29.1 million of the contingency is to be used to procure a replacement vessel to support the Chatham Islands. This funding has three conditions attached to its release.
 - 3.1 Ownership: Determine who is best placed to own and operate the new vessel.
 - 3.2 Operating Model: Understand the operating model for the new vessel and its sustainability. This includes how the new vessel will be operationalised and funded.
 - 3.3 Governance: Confirm the governance structure for procuring the vessel is robust and meets Government guidelines.

4 s 9(2)(f)(iv) [Redacted]

[Redacted]

[Redacted]

[Redacted]

7 s 9(2)(f)(iv) [Redacted]

- 8 s 9(2)(f)(iv) [REDACTED]
[REDACTED]
[REDACTED]
- [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED]
- 10 There are no immediate financial implications from this briefing, but agreement to provide communications to the Chatham Islands Trust will create expectations for future progress for the Chatham Islands.
- 11 The Treasury and the Department of Internal Affairs were consulted in the preparation of this briefing.

The operating model is a useful tool to understand the potential trajectory of the service but doesn't provide the full context

The prepared operating model outlines a 'base-case' for a potential vessel, based on a set of assumptions

- 12 As outlined in the previous briefing, the operating model under consideration by the project has been prepared by an external consultant who works closely with the Chatham Islands. The Ministry has reviewed this model and its assumptions in detail.
- 13 The full operating model contains a significant amount of detailed information to support the financial model. Based on this information the Ministry considers the operating model is a fair reflection of the revenue and costs of the shipping service in the short-term.
- 14 The operating model is based on a forecast revenue and costs of operating a vessel over a 25-year period. To undertake this forecasting, several assumptions are required, including:
- 14.1 Service frequency (i.e. how often the vessel journeys between the Chatham Islands and mainland New Zealand);
 - 14.2 Revenue and revenue growth rate;
 - 14.3 Various cost categories and their growth rates (including cost of fuel, crew, port fees, and general costs); and
 - 14.4 General inflation rate (CPI).
- 15 A summary of the key assumptions of the proposed operating model is contained in **Appendix 1**.
- 16 In general, the operating model is based on the current operating approach undertaken by Chathams Shipping Limited, on the basis that the replacement vessel will be functionally similar to the *Southern Tiare*. As such, the service frequency,

revenue per trip, and costs are based on the actual revenue and costs of the operation of the *Southern Tiare*.

- 17 However, the operating model makes several assumptions about the growth rates of revenue and costs. Critically, revenue is expected to grow in line with CPI inflation, however several cost categories (port fees and crewing) are forecast to grow year-on-year at 0.50 percent and 1.5 percent higher than inflation, respectively.
- 18 The model presents that in the short-term, the operating model for the vessel is expected to be cash flow positive. However, due to the forecast increases in costs being larger than the relative increases in revenue, over a number of years this has a compounding effect, resulting in a forecast negative cash-flow positions from year 8 onwards.
- 19 It is difficult to provide an accurate model across a 25-year time horizon, however the operating model prepared should be considered as a feasible 'base case', illustrating the potential operating model if no steps were taken and cost growth consistently outpaces revenue growth.

There are several interventions available to improve the base case operating model

- 20 The Ministry considers the operating model presented provides a good foundation to understand the path available for ensuring a sustainable shipping service for the Chatham Islands. Changes could be made to the operating model to represent different assumptions and growth rates, which would provide a different financial model but is not guaranteed to be any more accurate.
- 21 Rather, the Ministry has considered, in consultation with representatives from the Chatham Islands, a set of interventions which are available and presently used by the shipping service to ensure financial sustainability. The possible interventions are:
 - 21.1 Increasing prices to users in line with actual cost increases, rather than CPI inflation;
 - 21.2 Utilising the vessel for alternative revenue sources; and
 - 21.3 Reducing operating costs.
- 22 Currently, the shipping service does not automatically increase the costs for its users to reflect changes in operating costs. This is particularly as shipping costs are often a significant expense already for industry on the Chatham Islands, who may have a limited ability to absorb higher costs on a regular basis.
- 23 This has been represented in the operating model with growth in revenue being tied exactly to CPI inflation, rather than the weighted increase in costs. This has a material impact on the model – if this assumption is changed, the model concludes that the service would be consistently financially sustainable.
- 24 Traditionally, the vessel used to service the Chatham Islands also seeks alternative revenue sources beyond the Chatham Islands. While the general operating model for the vessel is not profit-seeking, these alternative revenue sources help offset increases in costs for Chatham Islanders.

- 25 The Ministry understands that this practice, while helping to meet the financial sustainability of the shipping service, also causes some service disruption to the Chatham Islands as the vessel can be running these alternative contracts for weeks at a time. This service disruption is balanced against the improved financial sustainability of the shipping service.
- 26 The operating model prepared for the replacement vessel does not include any consideration of alternative revenue sources or third-party contracts to support the financial sustainability. This is a principled approach based on the current circumstances to preparing a robust operating model, as alternative revenue sources depend on third-party demand and wider market dynamics, which are difficult to forecast and may not always be relied on.
- 27 Another element that is not considered within the prepared operating model is potential to reduce operating costs as a result of the new vessel, which would be expected to be more efficient. Fuel represents 21 percent of the costs of the vessel, and a modern vessel may be able to make significant savings. As the level of efficiencies are not yet known, they have not been factored into the operating model.

Interventions must be exhausted as part of the operating model

- 28 Overall, the operating model prepared outlines a pragmatic approach which shows the vessel is expected to be financially sustainable in the first 7-8 years of operation. Threats to the financial sustainability emerge in the longer term, depending on the costs and revenue dynamics present over a long period of time.
- 29 If the threats to financial sustainability eventuate, there are several interventions which are expected to be utilised by the service operator to ensure financial sustainability. These actions are in line with the practices of the current service, and are not a deviation from the current experience of shipping users on the Chatham Islands.
- 30 It has been clearly communicated by representatives from the Chatham Islands that these interventions, which were not factored within the 'base case' operating model, would be implemented as required to ensure the financial sustainability of the vessel. It is accepted that further government funding is not available to meet the operating needs of the vessel.

The operating model will continue to be refined as the project progresses

- 31 Additionally, the operating model will continue to be refined as the vessel project progresses. Particularly, further understanding of the expected fuel efficiency of the vessel is expected to result in material savings.
- 32 Ministers will have the opportunity to consider a further update to the operating model prior to contract signing as an element to subsequent draw-down requests. As the project progresses, the operating model's assumptions can be refined further to provide a clearer picture. Additionally, updated versions of the operating model can be refined to illustrate how interventions noted in this briefing will impact the financial sustainability of the vessel.

- 33 s 9(2)(f)(iv)

s 9(2)(f)(iv) [Redacted]

34 s 9(2)(f)(iv) [Redacted] s 9(2)(f)(iv) [Redacted]

We recommend writing to the Chatham Islands to confirm the project is progressing

35 The Ministry considers the work on the operating model at this point is sufficient to progress with the project, s 9(2)(f)(iv) [Redacted]

[Redacted] The difficulty forecasting costs over a 25-year period means that the project continues to carry some longer-term risks, but we are confident that appropriate steps will be taken to manage these risks to the extent possible.

36 The Chairperson of the Chatham Islands Enterprise Trust (the Trust) has written to Ministers to seek confirmation of the project status and voice concerns about delays to the project, given the project has not yet progressed to the delivery stage. On the basis of this advice regarding the operating model, approval is sought from Ministers to engage with the Chatham Islands and confirm the project's progress, via a response letter from the Associate Minister of Transport. This would provide reassurance to the Chatham Islands community and help maintain our constructive working relationship with the Trust.

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APPENDIX 1

- 1 The below table outlines the core assumptions made by the proposed operating model:

Table 1: Core model assumptions

Area	Assumption
Service frequency	28 services / year (14 Napier, 14 Timaru) Note: with a 2 day turn-around at each Port this leaves 163 days the vessel would be available for charter revenue
Revenue	Based on current rates against likely utilised capacity of the new vessel. Does not include any Charter revenue
Revenue growth rate	2.5% per annum (tied to CPI inflation)
General costs (includes items such as insurances, warranties, maintenance expenses, and all other misc. costs).	Based on existing service (pro-rated to vessel size)
General cost growth	2.5% per annum (tied to CPI inflation)
Port costs	Normalised against current costs with a small increase
Port costs growth rate	3.0% per annum
Crew costs	Slightly increased against existing vessel, based on information prepared by Swire for crewing requirements for a 70m vessel and at current market rates
Crew costs growth rate	4.0% per annum
Fuel costs	Based on existing service and commercially available rate of \$1.54/L. No efficiency factor included in the model
Fuel cost growth rate	2.5% per annum (tied to CPI inflation)