

2 September 2020

OC200714

Hon Grant Robertson
Minister of Finance
Action required by:
 Tuesday, 8 September 2020

Hon Phil Twyford
Minister of Transport
Hon Shane Jones
Minister for Regional Economic Development

GISBORNE RAIL LINE BUSINESS CASE

Purpose

Invite Regional Economic Development (RED) delegated Ministers' funding approval and funding transfer from Vote Business, Science, and Innovation (BSI) to Vote Transport for the Wairoa to Gisborne Rail Line (the Line) business case.

Key points

- In December 2019, Business and Economic Research Ltd (BERL) economists led a study on reinstating the rail line between Gisborne and Wairoa, concluding that reinstating the Line is feasible from an engineering perspective.
- KiwiRail has material reservations about the study, stating that costs to reinstate the Line could be five times the BERL study. They believe investing capital into the Line would be a high risk when there is no certainty on revenue and the Crown has no visibility of future cost exposure for the Wairoa to Napier section of the Line.
- At the request of delegated RED Ministers, this briefing outlines how we would undertake a business case. Phase one of the business case would seek independent assurance on KiwiRail's development of cost and revenue information. Then with Ministers reconfirmation, Phase two would see completion of the business case through an independent consultant. The consultant would engage with the community and build on the BERL study by highlighting dependencies and risks, particularly around affordability, procurement, and the Line's impact on the Gisborne area.
- The Ministry has significant concerns over the proposal to undertake a business case. Based on advice from KiwiRail, we believe it is unlikely the Line would be commercially viable and there is a risk that the Line would be an ongoing operating liability for the Crown. KiwiRail has indicated that they are not prepared to fund this investigation, the upfront reinstatement costs, or the ongoing operating costs.

Recommendations

We recommend you:

- 1 **agree** to \$0.82 million Provincial Growth Fund (PGF) funding for the Gisborne Rail Line business case. Yes / No
- 2 **approve** the transfer of \$0.82 million of PGF funding, from Vote Business, Science, and Innovation to Vote Transport, to implement the Gisborne Rail Line business case. Yes / No
- 3 **approve** the following changes to appropriations, to transfer funding from Vote Business, Science, and Innovation to Vote Transport for approved regional transport projects, with a corresponding impact on the operating and debt balances: Yes / No

| | \$m – increase/(decrease) | | |
|---|---------------------------|---------|--------------------|
| | 2020/21 | 2021/22 | 2022/23 & Outyears |
| Vote Business, Science and Innovation Minister for Regional Economic Development | | | |
| Multi-Category Expenses and Capital Expenditure: Regional Economic Development: Provincial Growth Fund Multi category appropriation | | | |
| Non-departmental Other Expense: Regional Projects and Capability | (0.820) | - | - |
| Vote Transport Minister of Transport | | | |
| Departmental Output Expenses: Transport – Policy advice, ministerial servicing, governance, and other functions (funded by revenue Crown) | 0.570 | - | - |
| Multi-Category Expenses and Capital Expenditure: Tuawhenua Provincial Growth Fund – Transport Projects Non-departmental Other Expense: Regional Projects and Capability | 0.250 | - | - |

- 4 **agree** that the proposed changes to appropriations for FY 2020/21 above be included in the 2020/21 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply. Yes / No
- 5 **note** that you will receive a progress report at the end of Phase one which will seek your approval to proceed to Phase two.

Erin Wynne
Director, Rail Transformation

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Hon Grant Robertson
Minister of Finance

..... / /

Hon Phil Twyford
Minister of Transport

..... / /

Hon Shane Jones
**Minister for Regional Economic
Development**

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Minister's office to complete:

Approved

Declined

Seen by Minister

Not seen by Minister

Overtaken by events

Comments

Contacts

| Name | Telephone | First contact |
|---|-----------|---------------|
| Bryn Gandy, Deputy Chief Executive | s9(2)(a) | |
| Erin Wynne, Director, Rail Transformation | | ✓ |
| Tony Frost, Team Lead, PGF | | |

GISBORNE RAIL LINE BUSINESS CASE

Purpose

- 1 Invite Regional Economic Development delegated Ministers' funding approval and funding transfer from Vote BSI to Vote Transport for the Wairoa to Gisborne Rail Line business case.

Background

- 2 Gisborne District Council has identified the refurbishment of the Line as a shovel-ready project. This Line is currently closed with rail activity limited to the section between Napier and Wairoa.
- 3 The Line runs through challenging topography and is subject to occasional heavy rainfall events, which has caused several major washouts, slips, and the subsequent closure of the Line in 2012.
- 4 The PGF funded Business and Economic Research Ltd (BERL) economists to lead a study on the feasibility of reinstating the Line. The study was released in December 2019, concluding that reinstatement of the Line is feasible from an engineering perspective at a cost of \$30-38 million over ten years (\$20-24 million upfront reinstatement), and that there is sufficient freight for five trains per week.
- 5 BERL assessed the costs for reinstatement of the Line to a level of service of 16 tonne axle weights travelling at 40 kilometres per hour, which is lower than the specification KiwiRail would require as a preferred standard. The availability and costs of rolling stock were not assessed. BERL concluded:
 - a *prima facie* case established there is sufficient demand for rail freight services; and
 - there are numerous environmental, social, and cultural wellbeing advantages in favour of the reinstatement option over either the closure or status quo option.
- 6 KiwiRail has stated that the costs to reinstate the Line could be five times the BERL study, and considers that it would be high risk to invest this capital when there is no certainty of sufficient southbound freight to justify the proposed investment. KiwiRail has clarified that the Crown should consider the costs of the entire Gisborne to Napier corridor, and not just the Wairoa to Gisborne section of the Line. A failure in the Napier to Wairoa section could render investment in this section redundant.
- 7 A business case would address the information gaps around commercial feasibility in the BERL study and assist the government in understanding the commercial revenues and costs associated with reopening the Line.

Ministry comment

- 8 At the request of delegated RED Ministers, we have outlined how a business case could be undertaken as a possible next step. The BERL study claims that a *prima*

facie case needs to be answered from an engineering perspective. However, based on KiwiRail advice, the Ministry believes it is unlikely the Line would be commercially viable.

- 9 An application from the Gisborne District Council to Crown Infrastructure Partners for \$36 million to fund reinstatement of the Line was not approved. At the time, KiwiRail indicated they were unwilling to fund this work or provide for ongoing operations on the Line as they were unconvinced of its commerciality.
- 10 The Line is outside the scenario of a “reliable and resilient” rail network under the Future of Rail programme, which is the basis agreed by Cabinet to fund rail under the NZ Rail Plan. Therefore, costs for reinstatement, maintenance, and rolling stock could not receive funding from the National Land Transport Fund. Funding would instead need to be injected from the Crown. Should the reinstated Line be unable to operate commercially, it would be an ongoing operating liability for the Crown.

Business case scope

- 11 The proposed business case would be guided by the Treasury’s *Better Business Case* model (single-stage) for strategic and programme phases. This approach is adopted due to the compressed timeframe for developing the business case.
- 12 We would take a phased approach to the business case. In the first phase KiwiRail would produce the cost and revenue information with a Ministry-appointed consultant testing the information as it is developed. The Ministry would provide RED Ministers with advice on the cost and revenue information and seek re-confirmation to proceed with Phase two based on the findings of Phase one.
- 13 The business case would build on the BERL feasibility study. The key points that would be covered under each Phase of the business case are detailed below:

Phase one: Confirm cost and revenue inputs for a business case

Revenue inputs

- The nature of freight movement and likely commercial demand for rail, including log movements between ports. Some freight could move to rail, including Gisborne’s fruit and vegetables, primary products, and processed timber exports.

Cost inputs

- The upfront cost of capital investment, ongoing costs of operation, and long-term maintenance costs for the rail network from Gisborne to Napier.
- The rolling stock capital and operating requirements in terms of the Line’s need for procurement of carriages or other relevant locomotives.

Phase two: Complete the business case

- Integrate the cost and revenue inputs from Phase one into the Economic and Financial cases.

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- Identify who would meet all costs to the extent these are not fully recoverable directly from customers (Financial case).
- Highlight any dependencies and risks that can be expected of the Line upgrade, particularly around affordability, procurement, and potential long-term liabilities for the Crown (Management case).
- The short-term and long-term benefits of reopening the Line, including creating jobs, economic growth, and improving Napier to Wairoa's environmental outcomes and road safety.
- The consequential effect on ports in the region. A business case would include strong stakeholder engagement with the local community and commercial interests, particularly communication with local iwi (Management case).
- Address the delivery and procurement arrangements (Commercial case)

Items out of scope

- 14 Investigation into assets and geotechnical conditions along the Line is out of scope for Phase one. However, such analysis may be necessary if the range in the cost information is too variable. If the findings of Phase one demonstrate a broad cost range, Ministers may agree before commencing Phase two or at a later date to further investigation into assets and geotechnical conditions before Phase two or at a later date (KiwiRail has identified \$3.6 million to fund this).

Governance

- 15 The Ministry would establish a Steering Group with monthly meetings attended by Director-level members from the Provincial Development Unit (PDU), KiwiRail, and the Ministry. The Steering Group would seek to ensure high level buy-in and engagement from each agency and the local community, seek the appropriate assurance over the project's evidence-base and analysis, and manage any risks as they develop.

Risks

- 16 KiwiRail has indicated that \$3.6 million is needed to properly investigate the cost of reinstatement (including \$100,000 for a commercial investigation). PDU has signalled that this extent of funds is unavailable. There is a risk that spending materially less than this will not advance the case sufficiently or lead to unreasonably low expectations of KiwiRail's delivery costs. To address this risk, we propose that the cost information be established as a first phase, and a decision to invest more into establishing accurate cost information can be considered before entering Phase two.
- 17 There is a risk that KiwiRail will not buy-into the business case process, which will be led by the Ministry and delivered through expert consultancy. It is necessary that this business case process achieves the full support of KiwiRail's technical and commercial teams. Without this input, the cost and revenue projections for the Line would remain unclear. Without more clarity on the cost and revenue projections, a

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financial case could not be made. It is critical that KiwiRail buy into the business case because KiwiRail would be expected to reinstate, own and operate the asset. This risk is addressed in this proposal by: KiwiRail leading Phase one, including KiwiRail in the Steering Group, and providing funding to support KiwiRail's contribution to the project.

- 18 There is a risk that the cost and revenue information generated in Phase one would be inaccurate or not credible to some parties. To address this risk, the Ministry would appoint independent and expert advice to question and test the cost and revenue information as it is developed.
- 19 There is a risk that the Phase one cost information may be too variable to usefully inform a business case. KiwiRail has previously submitted an estimate of \$3.6 million to properly cost the works to create a resilient network. This included geotechnical and other site investigations at a similar level to that completed for other major rail works. KiwiRail state that a provision of \$100,000 to cost this section will only allow for a desktop exercise and very modest improvement in the quality of any estimate, particularly for the large civil and structural works.
- 20 KiwiRail does not immediately have the capacity to carry out the Phase one work. KiwiRail notes that the technical staff needed for the costing works are confronting the Rolling Contact Fatigue issue in the Auckland Metro and preparing the work packages for the upcoming Christmas shutdowns. From KiwiRail's perspective, the Rolling Contact Fatigue and shutdown works must take priority, hence the costing exercise is proposed to start in 2021. For this reason the proposal has KiwiRail commencing work from January for completion in March 2021.
- 21 The Ministry is conscious of managing public perception risks around how the local community in the Gisborne area engage with this project. The Steering Group will be expected to evaluate whether or not to appoint an independent local representative to join the Steering Group and advise on community engagement where applicable. Similarly, the Steering Group will be expected to consider whether a local reference group should be established in the region.

Breakdown of costs and phasing for the business case

- 22 Detailed costing and market testing has not been completed, therefore, the budgets in the table below are estimates.

| Case | Description | Roles | Budget (\$) |
|---|---|------------------------|-------------|
| Phase one: Confirm cost and revenue inputs for a business case | | | |
| • Financial case: Commercial viability and revenues | Verify and expand on the market assessments done previously, including a commercial assessment of volume frequency, earnings to cover capital, and operator partner selection for container terminal road bridging. | KiwiRail | 100,000 |
| • Financial case: Costs | Assessment of costs and short/long-term maintenance to bring the Line to a resilient condition based on desktop information. | KiwiRail | 100,000 |
| | Assurance and testing of KiwiRail analysis and conclusions during their development. | Independent consultant | 50,000 |

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| Phase two: Complete the business case | | | |
|---|---|------------------------|------------------|
| <ul style="list-style-type: none"> • Strategic case • Economic case • Commercial case • Management case | Build on BERL study and KiwiRail's commercial viability and reports established above. Assess the economic impacts on the Gisborne region, including impact on Ports. Confirm short/long-term benefits associated with the project. | Independent consultant | 250,000 |
| | | KiwiRail | 50,000 |
| <ul style="list-style-type: none"> • All cases | Contractor(s) to manage the work above, and support the Steering Group. Travel and iwi/community engagement or potential reference group costs. | Ministry of Transport | 270,000 |
| Total cost: | | | \$820,000 |

- 23 The Ministry's costs are based on the North Auckland Line project experience, which involved significant Deputy Chief Executive, Manager, Senior, and Advisor level input to contract and manage the procurement and project delivery. There was significant iwi engagement at a senior level requiring specialist consultancy assistance. A local reference group was established and required six visits to the region by a delegation of senior officials.

Milestones

| Deliverables | Estimated Dates (assuming approval August 2020) |
|--|---|
| KiwiRail delivers cost and revenue information to the Ministry | January - March 2021 |
| Ministry advises Ministers on revenue and costs established in Phase one | April 2021 |
| Ministry appoints consultant | May 2021 |
| Consultant delivers Phase two report to Ministry | September 2021 |

Provincial Growth Fund criteria

- 24 PGF criteria post Covid-19 include the need to create jobs, be underway within 12 months, and have high public visibility. The business case would employ a consultant but would not provide any local employment. It could be underway within the desired timeframe, and would achieve public visibility through engagement with the community and iwi during Phase two.
- 25 The Ministry understands that the Line continues to be a low priority in terms of overall Future of Rail "reliable and resilient" rankings. The business case would aim to provide certainty over the best economic use of the Line among options of freight or alternative tourism uses. The business case would also serve as a stage-gate to any possible future Crown investment into the Line.
- 26 PDU has acknowledged Gisborne as an area that requires regional development assistance in order to reach its full social and economic potential. Correspondingly, Gisborne has been identified as a surge region for prioritised investment from the PGF.

Consultation

- 27 KiwiRail, PDU, and the Treasury have been consulted on the contents of this briefing.
- 28 PDU are comfortable with this proposed business case approach and cost structure, and comment that the two stage approach provides opportunities to manage the outcomes from Phase one.
- 29 KiwiRail agreed to deliver an updated costing within the time and cost parameters, but asked that Ministers take account of the comments in paragraph 19 on the limitations of costing as a desktop exercise.
- 30 The Treasury requested this paper clarify any limitations to the scope of the proposed business case so the limitations can be addressed by the supporting business case documentation in the event the investigation leads to a future Budget Bid.

PROACTIVELY RELEASED BY
THE MINISTRY OF TRANSPORT