



IN COMMITTEE

Agenda No 5C

Submission No TF 03/11/1301

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File No AF 89 02 02

Submission to the Transfund Board

IN COMMITTEE

Subject Application for Capital Funding for Wellington Passenger Rail

Purpose

- 1 To seek the Board's support for a capital funding contribution to greater Wellington Regional Council (GWRC) to secure public ownership of Tranz Metro Wellington and to support a request to the GWRC to prepare a business plan to cover refurbishment of existing rolling stock, purchase new rolling stock and carry out infrastructure upgrades.

Recommendations

- 2 That the Transfund New Zealand Board:
 - (a) **receives** submission TF 03/11/1301 Application for capital funding for Wellington passenger rail;
 - (b) **supports** a capital funding contribution to the GWRC for the purchase of Tranz Metro Wellington at a cost of up to \$80 million at a financial assistance rate of 60%, subject to:
 - (i) Transfund approving the relevant terms of any purchase of Tranz Metro and the exact contribution to be established by an independent valuation process approved by Transfund
 - (ii) GWRC carrying out an assessment of the proposal in accordance with Transfund's Allocation Process and demonstrating to Transfund's satisfaction that the proposal contributes to Transfund's objectives in an effective and efficient manner and establishes the contribution of the proposal to Transfund's statutory objectives.

- (c) **requests** the Chief Executive to advise the GWRC that a long term business plan should be commissioned by the GWRC that establishes a long term funding plan for Wellington passenger rail including rolling stock refurbishment, purchase of new rolling stock and infrastructure upgrades and includes a risk management strategy; and
- (d) **retains** submission TF 03/11/1301 “In Committee” until any negotiations to purchase Tranz Metro have been completed and the GWRC has been informed.

Background and Context

- 3 In the Chief Executive’s report to the Board in October 2003, we advised that Toll Holdings purchase of Tranz Rail has caused GWRC to consider options for the securing and improvement of passenger rail services in Wellington. One of the options is for GWRC to purchase Tranz Metro (Wellington). The intention would be to secure the rolling stock in public ownership and transfer the business elements to a new rail operator. Ownership of rolling stock by GWRC would enable much required refurbishment to commence.
- 4 GWRC has submitted a funding application which is appended as Attachment 1. This sets out a four stage process as follows:
 - Secure Tranz Metro in public ownership including public ownership of rolling stock
 - Appointment of a commercial operator to run the service using a procurement process to be approved by Transfund
 - Refurbishment of the existing rolling stock
 - Procurement of new rolling stock to replace existing rolling stock at the end of its useful life and to allow implementation of the rail passenger transport element of the Regional Transport Strategy.

Funding Application

- 5 GWRC has applied for Transfund funding as follows:
 - A funding contribution to purchase Tranz Metro Wellington at a cost of up to \$80 million at a FAR of 60% - the exact contribution to be established by an independent valuation process approved by Transfund
 - Assistance with the process to appoint a new operator. It is envisaged that Transfund subsidies to the new passenger rail operations would continue at a FAR of 60%
 - Funding support, at a level to be determined, for the refurbishment of existing rolling stock
 - Funding support, at a level to be determined, for the purchase of new rolling stock at a future date when necessary.

Wellington Rail Business Plan

- 6 An indicative forecast of future capital expenditure requirements is included as an appendix to GWRC's application in attachment 1. This is broken down into Tranz Metro purchase, rolling stock refurbishment and the purchase of new rolling stock.
- 7 The level of operating subsidy has yet to be established by the GWRC and will not be known until due diligence is carried out on the purchase of the business and tenders for the operations of the services are received. The level of subsidy may reduce from the current level of \$18 million per annum (approximately \$12 million Transfund share) as public sector ownership of the assets may lead to a lower cost of capital. However, other factors may cause the level of subsidy required to increase. For example, an increase in the levels of service could lead to a higher subsidy requirement.
- 8 The Board will be aware of the business planning process that has been followed for Auckland Rail. This approach allows the whole funding picture for passenger rail to be modelled in the long term – over a thirty year period in the case of Auckland rail. We consider that this approach is valuable to the Board when considering funding applications for individual components of the Business Plan.
- 9 Tranz Metro is currently owned by Tranz Rail / Toll Holdings. As a result, GWRC has yet to develop a business plan for the long term future of Wellington rail. We therefore recommend that GWRC commission a long term business plan for Wellington rail. This would allow the Board to consider future funding applications in the context of a long term business plan.

Coordination with Auckland Rail Purchase of New Rolling Stock

- 10 Transfund has received advice from our rail funding advisor, Arup, that further consideration should be given to combining the order for new rolling stock for Auckland and Wellington. The application from GWRC acknowledges this possibility and proposes to coordinate with Auckland to investigate any cost savings that might be achieved in the national interest.

Implications of Transfund Allocation Process and Fit with NZTS Objectives

- 11 The draft Transfund Allocation Process (TAP) involves a six-stage procedure.
 - Stage 1 Formulation
 - Stage 2 Assessment
 - Stage 3 Prioritisation
 - Stage 4 Programming
 - Stage 5 Approval
 - Stage 6 Monitoring

- 12 Proposals for the future of Wellington Rail have been in the “Formulation” stage for some years. The most recent proposals have revolved around the possibility of forming a Joint Venture between GWRC and an operator. However, the recently passed Land Transport Management Act allows the GWRC to purchase the Tranz Metro business and seek a competitively appointed operator. This is discussed further in the section on Ownership below.
- 13 Regarding the “Assessment” stage, a business plan and cost benefit analysis of the project has yet to be carried out. We therefore recommend that Transfund’s support is conditional upon GWRC carrying out an assessment of the proposal in accordance with the draft Transfund Allocation Process and that the assessment demonstrates to Transfund’s satisfaction that the proposal contributes to Transfund’s objectives in an effective and efficient manner.
- 14 “Prioritisation” and “Programming” of the cash flow will need to be carried out once the purchase price of Tranz Metro has been established and a long term rail business plan prepared. This could be carried out as part of the 2004/05 prioritisation process in May 2004. This is discussed in further detail in the section on Implications for Transfund 10 year forecast below.
- 15 Regarding the “Approval” or otherwise of specific funding. We suggest that:
- sufficient funds are currently available in the National Land Transport Fund for the purchase of Tranz Metro up to \$80 million (at a FAR of 60 %) to be carried out on a capital basis in 2003/04. However final approval of any support from Transfund is subject to due diligence and GWRC demonstrating that the proposal is an efficient and cost effective use of funds
 - funding approval for any future refurbishment or renewals of rolling stock would be subject to GWRC preparing a long term business plan and separate funding applications for specific proposals. Each funding proposal would need to be consistent with the long term business plan and would be subject to approval on its own merits
 - programming and prioritisation of potential funding for Wellington rail refurbishment and renewal should be considered as part of the 2004/05 NLTP process.
- 16 “Monitoring’ will be addressed by GWRC undertaking regular updates to the business plan and risk management strategy. Transfund will monitor and audit the performance and overall effectiveness of the proposal in line with our normal business procedures, and advise GWRC accordingly.

Scope of Key Infrastructure Purchase and Refurbishment/Renewal Proposed

- 17 The GWRC application seeks funding support for the Tranz Metro business, access rights and key infrastructure not transferred by Tranz Rail to Track Co (for example, stations and commuter car parks). The extent of assets transferred to Track Co has yet to be established, and as a result the extent of key infrastructure to be purchased by GWRC has also yet to be established. However the purchase of the Wellington station by the Crown has been signalled in press reports.

- 18 We have advised GWRC that ownership of stations and car parks is likely to be a TLA responsibility. We anticipate there will need to be further discussion on this topic. We would welcome the Board's views on this aspect.
- 19 The future scope of refurbishment is outlined in the appendix to GWRC's application in attachment 1 and includes:
- Second refurbishment of the Ganz-Mavag 88 cars
 - Refurbishment of 33 English Electric units
 - Refurbishment of 20 SA units for use on the Wairarapa and Kapiti lines
 - Purchase of a new fleet commencing in 2007/08 over a 20 year period. Acceleration of this programme may reduce the number of English Electric units that need to be refurbished
 - Extension of electrification to Waikanae.

Economic Evaluation

- 20 An economic evaluation has been carried out by GWRC that estimates the economic benefits to the region of continuing the rail service are approximately \$250 million per year. GWRC claim in their application that this implies a cost benefit ratio of about 10, which appears high given that total operational costs are about \$50 million per year. We accept that closing the rail service would lead to unacceptable levels of congestion on the road network, and therefore the benefits of keeping the service running exceed the costs. Further assessment of the total benefits and cost effectiveness of the proposal will need to be carried out as part of the business plan process.

Financial Assistance Rate (FAR)

- 21 The Board resolved at its October 2003 meeting, submission TF 03/10/1289 refers, that until the final funding policy for passenger rail services and infrastructure is introduced, passenger rail will be funded at a financial assistance rate of 60%. The GWRC application requests a FAR of 60% which is consistent with the Board's policy.

Implications for Transfund 10 Year Forecast

- 22 The refurbishment of rolling stock is identified as a possible project in the 2003/04 NLTP, but no funding amount is identified. The current 10 year plan provided for rail subsidies to continue at a level similar to current subsidies, in real terms, but acknowledged that an increase to reflect increases in funding for the development of the Auckland and Wellington passenger rail systems may be necessary.
- 23 Given that capital funding of a similar scale or greater to Wellington rail is also being considered for Auckland rail, an increase in the \$28 million per year allocated in the 10 year plan to alternatives to roading over the ten year period would be necessary if Transfund were to approve funding for both projects on a capital basis, from this output class.

- 24 However over the next three years period it is anticipated that sufficient funds will be available to fund capital requirements for Auckland and Wellington rail, given the current cash-flow situation and the proposed contribution to the Auckland project by Infrastructure Auckland. In the longer term, lease financing of new rolling stock could be considered to spread the cash-flow if that becomes necessary or is found to be a more cost effective option. Further consideration of the cash flow implications will need to be considered as part of the Wellington rail business planning process.
- 25 GWRC's indicative forecast of capital spending is included on Appendix 1 of its submission. The total forecast capital spending over ten years is up to \$80 million for the initial purchase plus approximately \$260 million for refurbishment, renewals and upgrades giving total capital spending of up to approximately \$340 million.
- 26 Current operating subsidies are \$18 million per annum and if continued at that level would total \$180 million over ten years. However, operating subsidies are expected to reduce due to the purchase of the assets that have been valued at up to \$80 million. For example, if a 10 % rate of return on an \$80 million investment is assumed, subsidies could reduce by \$8 million per annum from \$18 million to \$10 million per annum..
- 27 The total Transfund investment sought at a 60% FAR is therefore up to \$204 million capital and \$60-\$108 million operating cost, or a total cost of \$264 - \$312 million over ten years. This is subject to confirmation of the Tranz Metro purchase price, which could be lower, and confirmation of the true operational subsidy required.

Possible Concern about Double Funding

- 28 As advised to the Board in its consideration of input funding for Auckland rail, one possible concern with funding the rolling stock refurbishment could be the prospect of double funding, if operational subsidies were to be based on patronage. Though rail was separated from bus and ferry in the development of the revised patronage scheme, initially it had been contemplated that an output based funding scheme would also be developed for rail. Recently, however, we have discussed with the Board our preference for an input based scheme for passenger rail for 2004/05 – and possibly subsequent years as well. The Minister has been advised accordingly and in his letter to Transfund dated 18 August (attached), agreed with this approach.
- 29 Given this shift towards input based funding – at least for an interim period – we consider that we will be able to avoid double funding of this rolling stock refurbishment.

Ownership

- 30 Given the purchase of the rail network by the government and the imminent formation of Track Co, and given the level of capital investment that may be needed in Wellington rail over the next few years, a publicly owned infrastructure model is now GWRC's preferred option.

- 31 We agree that this option appears to be the most suitable provided that Tranz Metro can be purchased from Toll Holdings at a reasonable price. That price has yet to be established and will be the subject of due diligence and negotiation between GWRC and Toll Holding.

Procurement Procedure Issues

- 32 A procurement procedure for the refurbishment of the existing rolling stock has yet to be advised by the GWRC. A sole supplier procurement procedure similar to that used for the refurbishment of Auckland rolling stock is envisaged. A detailed procurement procedure will need to be developed by the GWRC for approval by Transfund prior to commencing procurement.

Risk Management

- 33 A risk management strategy will need to be developed by GWRC for approval by Transfund prior to proceeding with the proposal. Part of the risk management strategy will be the development of a long term rail business plan.

In Committee Status

- 34 This submission is in committee due to the commercial and sensitive nature of the proposal. We recommend submission TF 02/9/1271 be kept "In Committee" until any commercial negotiations to purchase Tranz Metro are complete and the GWRC have been informed.

Attachments

- 35 There are two attachments with this submission:

- Attachment 1 Submission from GWRC for capital funding of Wellington passenger rail infrastructure
Attachment 2 Letter from the Minister dated 18 August

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