

The Treasury

Budget 2017 Information Release

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[1]	to prevent prejudice to the security or defence of New Zealand or the international relations of the government	6(a)
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[38]	to enable the Crown to negotiate without disadvantage or prejudice	9(2)(j)
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[40]	Not in scope	

In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Reference: T2017/558 SE-2-25-0

Date: 10 March 2017

To: Associate Minister of Finance (Hon Simon Bridges)

Cc: Minister of Finance (Hon Steven Joyce)
Minister for State Owned Enterprises (Hon Todd McClay)

Deadline: None

KHL Initiatives – Budget 2017

You are meeting with KiwiRail Holdings Ltd (KHL) at 12pm on Tuesday, 14 March. The following will be in attendance from KHL:

- Dame Paula Rebstock, Deputy Chair KHL
- Peter Reidy, Chief Executive Officer (dialling in from the US)
- Dave Gordon, Group General Manager Asset Management and Investment

The purpose of this note is to provide you with (i) an overview of KHL's Budget 2017 initiatives, (ii) talking points for your discussion with KHL, and (iii) dates of key upcoming budget meetings.

Overview of KHL's Budget 2017 initiatives

The table below provides a summary of KHL's Budget 2017 initiatives.

Budget 2017 Initiatives	Capital support for KHL	Rollover of KHL debt facilities	Wellington Metro-Rail upgrades	Reinstatement of the Main North Line post the earthquake
Value (\$m)	[33]	\$174	\$98.4	[37]
Initiative description	Capital support for KHL's rail freight operations	Rollover of debt facilities provided to KHL that mature in 2017/18	Replacement timber poles and overhead wires on the Wellington metro rail network	Reinstatement of the Main North Line post the earthquake (this figure does not include any insurance proceeds)
Budget stream	Capital	Capital	Capital	Capital
Treasury's Assessment	Currently being reviewed	Support	Support	[37]

We discuss each initiative on the following pages.

Capital Support for KHL

KHL initially submitted ^[33] (T2017/156
and T2017/451 refers). ^[33] (discussed
further below). The Treasury is working with the Ministry of Transport (the Ministry), Mr
William Peet and Mr Geoff Dangerfield to prepare a report on this initiative to be
provided the week beginning in 20 March to inform the discussion of the capital
package at the 28 March Investment Ministers meeting.

We summarise the key findings from our analysis so far below:

\$m	FY13	FY14	FY15	FY16
Revenue	727	741	721	694
Expenses	621	664	630	618
EBITDA	105	77	91	76
Asset Sales	6	2	18	22
Other	(60)	51	(57)	(54)
Total Cash Available	54	130	51	44
Total capex	304	249	249	254
Crown Funding	250	119	198	210

We make the following observations:

- The decline in historical revenue is impacted by (i) the loss of the Wellington metro contract, (ii) a change in the accounting treatment for the Fuel Adjustment Factor (FAF), and changes to underlying customer revenue. We have requested a detailed breakdown of the revenue by source (this has not yet been provided by KHL).
- KHL's EBITDA has declined by \$29 million over the period from FY13 to FY16. A decline in revenue from bulk freight primarily due to reduced coal and bulk milk volume has contributed to the decline in earnings. This has been mitigated by growth in IMEX freight revenue. EBITDA has also been impacted by cost savings initiatives implemented in FY16, which include a reduction in head count and overtime, reduction in the vehicle fleet and a general reduction in overhead and discretionary expenditure.
- While KHL was forecasting an improvement in EBITDA for FY17f, this is unlikely to eventuate following the impact to the business following the Kaikoura earthquake.
- [37]

- KHL has presented two alternatives for the level of rail network expenditure (the 'Resilient' and 'Deferred' alternatives). The forecast capex presented in the table is based on the lower 'deferred' rail network alternative and does not include potential cost savings [37]
- The table also compares the total historical revenue and expenditure over the last five years (Hist.) to the forecast revenue and expenditure per the budget bid (F'cst). KHL is forecasting to spend [37] which is a
- Under the 'deferred rail network alternative' KHL is now requesting [33] capital funding [33] This is a

Rollover of KHL Debt Facility

The Crown has provided a debt facility to KHL which is due to mature in 2017/18. KHL is requesting that this facility be rolled over for a further term. The roll-over of this facility does not have an impact on core Crown net debt and is fiscally neutral. This

facility was not forecast to be repaid and was counted against allowances at the time it was established.

Wellington Metro-Rail upgrades

This initiative is to fund deferred maintenance on the Hutt Valley, Melling and Johnsonville metro-rail lines. Metro-rail is subject to a different funding model to the freight business, and therefore this initiative is separate to KHL's capital requirements for the freight network.

At Budget 2016, this initiative was deferred and KHL was directed to develop a business case to support a future funding request. The Ministry also commissioned an independent review of the programme of works to determine the urgency and assess the cost estimates.

The findings of these two reports informed our recommendation to fund this initiative. In particular, the Ministry's report supported KHL's assessment that this work needs to be completed by 2021 to avoid significant safety risk and associated line closures.

Reinstatement of the rail line post-earthquake

A draft Cabinet paper on the Southern Transport Corridor reinstatement project was provided to you on Friday, 10 March (OC04840 refers). [37]

You are meeting with senior Ministers and project leads from KHL and NZTA on Monday, 13 March to discuss progress and next steps for the Southern Corridor Reinstatement project. The cover briefing to the draft Cabinet paper provides you with the key areas for discussions at this meeting, with a particular focus on seeking further detail on the cost assumptions (in particular, a breakdown of the costs by section – to better understand where the costs and risks for the reinstatement are) from both KHL and NZTA.

Talking points for your meeting with KHL

The discussion with KHL is likely to focus on (i) KHL's capital request, and (ii) reinstatement of the Main North Line. We request that the Minister raise the following points with KHL:

- The total capital allowance (less pre-commitments) for Budget 2017 is [33]
The total amount of capital requested against this allowance is [34]
- The Treasury has requested KHL [34]

[34]

- The Treasury and the Ministry are working with their advisors and KHL to provide advice to Ministers on (i) KHL's capital request, and (ii) reinstatement of the Main North Line. It is important the KHL provides any information requested by officials by Friday, 17 March to ensure the advice and recommendations received by Ministers is well-informed.

Key upcoming Budget Meetings

During March and April there are a number of key budget meetings, where the KHL initiatives will be discussed and any funding for these agreed. It is important that KHL provides all relevant information by Friday, 17 March so that analysis can be undertaken to inform the report to be provided ahead of the Tuesday, 28 March Investment Ministers meeting. These meetings are outlined in the table below.

Date	Meeting	Description
Monday, 13 March	Investment Ministers	Discussion of recommendations from the investment panel and draft capital package
Monday, 20 March	Budget Ministers #2	Fiscal Strategy and draft packages
Tuesday, 28 March	Investment Ministers	Final capital package to be discussed
Monday, 3 April	Budget Ministers	Final budget packages agreed

Should you require any further information please contact the following:

[23] Analyst, National Infrastructure Unit (NIU), [39]

Chris Gregory, Manager, Commercial Operations - Governance and Performance,
[39]