Information for release – notes on this document:

Please note background information in this paper included two errors. The errors relate to the information below.

Paragraph 7:

The funding of the renewals over the past years has been somewhat ad hoc, and the result of convenient funding agreements reached by the previous Government. The principal funding agreements from which some renewal costs have been funded have been the DART Crown appropriation in Auckland (funding began in June 2006) of $600, 000; and the Crown appropriation in the Wellington Metro Rail Upgrade Agreement (November 2006) of $125,000. The funding available through these Crown agreements is coming to an end. The network division of KiwiRail (ONTRACK) has also incurred operating losses in some years[1] partly due to subsidising metro renewals.

Recommendation 4:

Note that over the previous four years the funding shortfall for metro renewals has been met by significant Crown funding through the Auckland Rail Development (Project DART: $600,000) and Wellington Rail Development (Project WARP: $125,000) upgrade work, as well as operating losses for the network division (ONTRACK);

Both of the dollar amounts below should have been represented in millions rather than thousands and the paragraphs should read:

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The resulting Cabinet decision (minute) is correct as it was amended to reflect this error.

1. Deloitte 's Review of KiwiRail Business Plan
2. Deloitte 's Review of KiwiRail Business Plan

Office of the Minister of Transport

Chair
Cabinet

METRO RAIL NETWORK COSTS FOR ONE YEAR

Purpose of paper

1. To inform Ministers of the need to fund the renewal metro rail network costs faced by KiwiRail Group in Auckland and Wellington, and the need for a 1-year budget bid of $21.139 million for 2010/11.

Background

2. The KiwiRail Group produced a Turnaround Plan in January 2010 that envisages total capital expenditure over 10 years of approximately $4.6 billion. (See separate paper on KiwiRail Group Turnaround Plan). This expenditure is inclusive of capital requirements for the metro portion of the network. The Turnaround Plan has recently been the subject of a due diligence exercise and report by Treasury and the Ministry of Transport.

3. The Government policy is that the costs of providing metro rail services will be met by the users of the service and the regional councils.

The proposal

4. The Minister of Transport and the shareholding Ministers for KiwiRail Group (KRG) are moving to put KRG onto a commercial basis. It is also our intention to set KiwiRail Group up on a sustainable basis with respect to its freight business, and it should not be required to subsidise any metro costs. It is therefore important to correct past anomalies and funding distortions; and provide more coherent funding mechanisms via a new funding framework.
5. This framework includes:
   - The different trading businesses within the KiwiRail Group should stand alone and not cross subsidise one another;
   - There should be a greater share of rail funding sourced from users, i.e. all stakeholders should have to take on their share of the costs; and
   - Where the network business (the below track infrastructure) incurs costs in maintaining its assets (as defined in the asset management plans), the maintenance and renewal of these should be recovered from the users.

6. The Auckland and Wellington track network is used for both metro and freight purposes, and therefore the costs should be apportioned fairly between these users. To date, this has not happened under the previous ownership arrangements in a transparent clear manner, partly because of the difficulty of getting Toll Inc to agree

the track access renewal costs it should bear. With the creation of one integrated rail company, KiwiRail Group, it is now possible to do this.

7. The funding of the renewals over the past years has been somewhat ad hoc, and the result of convenient funding agreements reached by the previous Government. The principal funding agreements from which some renewal costs have been funded have been the DART Crown appropriation in Auckland (funding began in June 2006) of $600, 000; and the Crown appropriation in the Wellington Metro Rail Upgrade Agreement (November 2006) of $125,000. The funding available through these Crown agreements is coming to an end. The network division of KiwiRail (ONTRACK) has also incurred operating losses in some years[3] partly due to subsidising metro renewals.

8. The complexity of the pattern of the funding for renewals has not helped transparency.

9. The Ministry of Transport is leading a Working Group on Track Access Charges in order to facilitate agreement on renewal costs, and new track access charges and agreements between KiwiRail Group and regional councils. The Working Group is made up of members from Auckland Regional Council, Auckland Regional Transport Authority, Greater Wellington Regional Council, KiwiRail Group and the New Zealand Transport Agency (NZTA), and Treasury has been invited to join. The negotiations will be concluded later in 2010.

10. In line with the framework outlined above, my expectation of this work is that regional councils and users will meet the fair costs.

11. Achieving this change is necessary, but the problem is timing. Firstly, regional councils are not set up to meet this change in funding and policy for the 2010 / 2011 year. It represents a significant change to their current 3 year Long Term Council Community Plans if additional rates are to be raised.

12. Secondly, the NZTA is already fully expending its allocation for public transport subsidies under the current Government Policy Statement on Land Transport Funding (GPS) and the National Land Transport Programme is fully committed until 2012.

13. Thirdly, the current levels of service in Auckland and Wellington do not present a helpful climate in which to increase fares. Fare increases that contribute to costs are more likely to be acceptable when the new electric passenger trains due to arrive over the next few years actually deliver a better service.

14. This means that the funding changes need to occur over a period of time. They cannot occur immediately.

15. The estimated shortfall to run the metro networks is $21.139 million for 2010/11. This is made up of $9.57 million for Wellington renewals, $7.37 million for Auckland renewals, and $4.2 million for maintenance, train control and other network operating costs. This amount is to be treated as an upper limit. The appropriation will be managed by the Ministry of Transport informed by the Working Group.

16. I am also requiring that the projected renewal costs put forward by KiwiRail be thoroughly tested through the process of the Working Group. This testing of renewal

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[3] Deloitte 's Review of KiwiRail Business Plan

projections will form the equivalent scrutiny of the business cases that are to be required before Crown money is drawn down for investment in the freight business side of rail. We also need the regional councils to become “smarter buyers” of the track services, and in full knowledge of the real costs, determine exactly what service levels, i.e. frequency and reliability, they can afford.

1-year Budget Bid for Metro Rail Network Costs for 2010/11

17. I am seeking support for a separate, 1-year budget bid of $21.139 million to provide funding for KiwiRail Group’s metro rail network costs for the Wellington and Auckland metro networks for 2010/11 only. This funding will allow KiwiRail Group to take all practicable steps to ensure the safety and reliability of these metro networks and allow scheduled services to continue operating. The freight business will also be a beneficiary of this spending because of the shared track.

18. For the longer term, the Ministry is working on a new rail track access agreements and charges to implement the Metro Operating Model agreed by Cabinet in September 2009 [CAB Min (09) 35/5 refers]. This work will ensure that the users of the metro rail network have input into the level of service required from the metro network and pay the appropriate transparent costs associated with their use.

Comment from Treasury

19. Treasury notes that this request for $21.139 million for metro rail will reduce the amount available to all Ministers in the between-Budget contingency.

20. Treasury agrees with the policy that all rail network costs in metropolitan areas should be borne by both freight and metro users, and agrees that the central problem is the time being taken to reach settlement on the track access charges.

21. KiwiRail has been consistently under-recovering from metro users and funders, which has been masked in recent years by the Crown providing funding for renewals as part of rail upgrades in Auckland and Wellington. The end of this funding source has highlighted the subsidy that the regions have been receiving over and above what they receive via the passenger transport subsidies from the NZTA. In essence this paper seeks a direct subsidy for the Wellington and Auckland ratepayers, rather than contributing to the financial sustainability of KiwiRail, as per the KiwiRail Turnaround Plan.

22. Treasury’s preference is for the regions, NZTA and KiwiRail to reach immediate agreement about how to fairly apportion the full costs of the metro network. Given that regional councils have the statutory responsibility for providing public transport services, then Treasury considers they are best-placed to make the appropriate trade-off between service level and cost. If renewals are deferred, metro trains can still run, but may be slower and less frequent than if the appropriate level of work was undertaken. This provides a powerful incentive for the regions to reach rapid agreement about their share of the costs.

23. While Treasury acknowledges that pragmatically it will be difficult for the regions to reach immediate agreement with KiwiRail and source the funding required, it is

concerned that the Crown continuing to provide a subsidy to the regions for a full year will prejudice the negotiations, taking pressure off the regions to reach rapid settlement.

24. One option for Ministers could be to scale this bid to an amount sufficient to maintain service levels in the short-term, but also maintain pressure on the negotiating parties to reach a hasty settlement.

Financial implications

25. The proposal will create a new Crown appropriation of $21.139 million for 2010/11.

Human rights, Legislative Gender and Disability Implications

26. None.

Regulatory Impact Analysis

27. No regulatory impact analysis is required.

Publicity

28. There may be appropriate publicity once the Budget 2010 decisions are announced.

Recommendations

29. It is recommended that the Committee:

    1) **Note** that the Government's expectation on the KiwiRail Turnaround Plan and the metro rail operating model policy adopted in September 2009, [CAB Min (09) 35/5] is that the different businesses within KiwiRail Group should not cross subsidise one another;

    2) **Note** that the Government's expectation policy for the KiwiRail Turnaround Plan is that there should be a greater share of revenue sourced from stakeholders and users of the services, and this policy applies equally to the metro network;

    3) **Note** that usage and renewal of the metro track network is shared by both metro and freight users;

    4) **Note** that over the previous four years the funding shortfall for metro renewals has been met by significant Crown funding through the Auckland Rail Development (Project DART: $600,000) and Wellington Rail Development (Project WARP: $125,000) upgrade work, as well as operating losses for the network division (ONTRACK);

5) **Note** that it is the Government's intention that the metro rail network users and the regional councils and New Zealand Transport Agency pay their fair share of the renewal costs for the network in Auckland and Wellington;

6) **Note** that the transfer of responsibility of costs for metro rail cannot be achieved immediately because: regional councils would have to significantly increase rates, the New Zealand Transport Agency has already fully committed its public transport activity class in the National Land Transport Fund, and passenger service levels do not yet support fare increases that contribute to costs;.

7) **Note** that officials have begun negotiations with the two regional councils and the New Zealand Transport Agency to determine their share of the metro costs, and that the amount of these projected costs as provided by the KiwiRail Group is also being tested;

8) **Note** the immediate issue is the ability of the regional councils and the New Zealand Transport Agency to meet the shortfall in the 2010/11 year;

EITHER (Ministry of Transport preference)

9) **Agree** to establish a new Non Departmental Other Expense "Metro Rail Network Costs" in Vote Transport;

10) **Agree** that the output class scope shown in the Estimates will be "This appropriation is limited to the costs unrecovered from third parties in relation to the Auckland and Wellington metropolitan rail networks";

11) **Note** the total request is for funding of $21.139 in 2010/11 which according to KiwiRail is a full year of unrecovered costs;

12) Information deleted – negotiate without prejudice

13) **Approve** the following changes to appropriations, with a corresponding impact on the operating balance

	Increase / (Decrease) $m				
Vote Transport **Minister of Transport**	**2009/10**	**2010/11**	**2011/12**	**2012/13**	**2013/14 & Outyears**
Non Departmental Other Expense: Metro Rail Network Costs	0.000	7.046	0.000	0.000	0.000

14) **Agree** that the proposed changes to appropriations be included in the 2010/11 Estimates, and that in the interim the increases be met from Imprest Supply.

15) *[information deleted in order to enable the Crown to negotiate without disadvantage or prejudice]*

16) **Agree** not to fund the $21.139 million shortfall in 2010/11 from Crown appropriations.

Hon Steven Joyce
Minister of Transport

Dated:________________________________