

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)
[4]	to prevent prejudice to the maintenance of the law, including the prevention, investigation, and detection of offences, and the right to a fair trial	6(c)
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[31]	to maintain the current constitutional conventions protecting collective and individual ministerial responsibility	9(2)(f)(ii)
[33]	to maintain the current constitutional conventions protecting the confidentiality of advice tendered by ministers and officials	9(2)(f)(iv)
[34]	to maintain the effective conduct of public affairs through the free and frank expression of opinions	9(2)(g)(i)
[36]	to maintain legal professional privilege	9(2)(h)
[37]	to enable the Crown to carry out commercial activities without disadvantages or prejudice	9(2)(i)
[38]	to enable the Crown to negotiate without disadvantage or prejudice	9(2)(j)
[39]	to prevent the disclosure of official information for improper gain or improper advantage	9(2)(k)
[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: T2017/451

SE-2-25-0

Date: 3 March 2017

To: Minister of Finance (Hon Steven Joyce)
Minister of Transport (Hon Simon Bridges)
Associate Minister of Finance (Hon Amy Adams)
Minister for State Owned Enterprises (Hon Todd McClay)

Deadline: None

Aide Memoire: KiwiRail Capital Requirements

KiwiRail Holdings Ltd (KHL) has submitted a bid for a commitment of [33] of capital funding for the [33] as part of the Budget 2017 process.

The initial submission was based on a capital expenditure programme over the [33]
The capital expenditure programme includes:

- two alternatives¹ for the capital expenditure required for the rail network infrastructure:
 - Resilient [33] which allows for gradual improvement in the service level for priority routes, or
 - Deferred [33] which defers expenditure out beyond the expected life of the asset.
- [33]

We note that KHL's request for capital funding does not include (i) funding for re-instatement of the damage sustained following the Kaikoura earthquake, or (ii) funding for the metro networks. These are being addressed under separate budget submissions.

A summary of the initial submission and comparison to historical funding provided to KHL is provided in Appendix 1.

¹ A third alternative "Future-proofed" was discounted as it was not considered affordable.

KHL's Revised Submission

The Treasury requested KHL to present alternatives for the capital funding that require a significantly lower amount of capital or are for a shorter time period (or both). KHL has revised its capital request and has also provided suggestions as to how the capital request could be reduced further. The table below summarises KHL's revised submission:

[33], [35]

We make the following comments:

- For the purposes of the table above, we have used the lower “deferred alternative” rail network expenditure. KHL has revised its submission to [33]
- The rolling stock and other capital expenditure levels remain unchanged from the initial submission.
- [33]
[25]
- [33]
- KiwiRail has also raised the possibility of accessing alternative sources of capital to fund up to [33] This is discussed in further below.

[33]

[34], [37]

[34]

Alternative Sources of Funding

KHL suggest that it could fund some of the [37] by way of debt financing. KHL estimate that this could reduce the level of Crown funding [37]

We note the following:

- Any debt facility would need to be secured solely against the underlying asset [37] and have no claim against (i) KiwiRail's business operations, (ii) its other assets, and (iii) the Crown.
- [37]
- This type of facility would in effect provide the Crown with a put option on the [37]. If KHL is not able to generate sufficient earnings to service the debt, it would be likely to call on the Crown to meet the debt obligation. In this situation the Crown has the option to either (i) meet the debt obligation, or (ii) allow the debt provider to realise the security (i.e. put the [37] to the debt provider as settlement for the debt). This option is only available to the extent that KHL is able to continue to provide services (albeit at a lower level of service offering) if the security is realised. This places a limit on the level of [37] that may be pledged as security for the debt.
- An asset backed facility is likely to have a higher cost than funding provided by the Crown. However, KHL taking on additional debt would not impact core Crown net debt.

In our view, [37]

However, we consider that there is merit for KHL to explore this alternative for funding some (but not all) of the [37]

Actions by Ministers

We make the following requests:

- Ministers consider either a meeting with, or a call to, the Chair of KiwiRail to [34]
- Provide feedback on the [37]
- Provide feedback on the appetite of Ministers for KHL to explore using debt (on the terms presented in this paper) to finance the acquisition of some (but not all) [37]

[23]

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

Appendix 1: Financial Summary of KHL's Initial Submission

Table 2: Summary of KHL actual and forecast financial performance

\$m	FY13	FY14	FY15	FY16
Revenue	727	741	721	694
Expenses	621	664	630	618
EBITDA²	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

* The total capex is based on the Resilient alternative for the rail network infrastructure expenditure.

² Earnings Before Interest, Tax, Depreciation and Amortisation (EBITDA) is a measure of financial performance.