

20 April 2021

Hon Dr David Clark
Minister for State Owned Enterprises
Private Bag 18041
Parliament Buildings
Wellington 6160

Dear Minister Clark

RE: PROJECT IREX

Thank you for the 8 April 2021 letter regarding Project IREX (the Project). The renewal of the Interislander ferry fleet and building of resilience into the Picton and Wellington ferry terminals is critical infrastructure supporting New Zealand's transport network. We appreciate the Crown's \$435 million commitment to the Project.

The final detailed business case is scheduled to be signed off at the KiwiRail Board in June and formally presented to you and your officials for review shortly after. Prior to this, we have scheduled a session with your Treasury, Ministry of Transport, and Infrastructure Commission officials to take them through the work since the previous business case and March Programme Update.

We will seek to enter contracts after Ministers approve the detailed business case and special resolution to undertake a major transaction. It takes four to five years to commission and build a new ship. The cost and risk of maintaining the existing fleet to meet minimum maritime class and safety requirements will become prohibitive by 2025 so replacement vessels are needed in 2025 and 2026, with contracts entered in 2021. This timing is needed to maintain interisland supply chain connectivity and ensure service continuity for our freight and tourism customers.

As noted in our briefings on the Project, KiwiRail entered a letter of intent with the Hyundai Mipo Dockyard (Hyundai) in December 2020. This followed a competitive tender process which found that Hyundai offered the highest quality ship build and lowest whole of life costs. The purpose of the tender was to secure a price and shipyard build slots; however, the letter expires on 30 June 2021. KiwiRail will initiate negotiations with Hyundai to extend the letter a few weeks to provide Ministers more time to consider the detailed business case. Broadly speaking, this would enable Ministers to consider the detailed business case in June, take decisions in July, and for KiwiRail to enter contracts subsequently. This timeline is necessary to meet supply deadlines in 2025 and 2026.



We must flag, however, that extending the letter of intent is not without risk to pricing and build slots. For instance, steel prices have risen 10% since the offer from Hyundai was received. Accordingly, we ask that your officials prioritise their review to support you in considering the detailed business case as soon as practicable.

Of course, we need to demonstrate to you that the Project can be delivered with an appropriate net present value that justifies the Crown's investment, utilises prudent commercial debt, and is supported by reasonable investment from the ports (and their ownership Councils). This is exactly the focus that the KiwiRail team is giving as we finalise the detailed business case.

The Cook Strait connection is a strategic national asset and a vital commercial business for KiwiRail. It is the State Highway 1 of rail and road. The existing ferry fleet and port assets are nearing the end of their useful lives. Their renewal represents substantial economic, resilience and environmental benefits to New Zealand by continuing and improving the connection of people, freight, and supply chains between the North and South Islands.

The Project also responds to your expectations to improve KiwiRail's commercial performance. The new fleet will increase freight and passenger capacity (in line with market growth), improve service reliability, reduce operating and maintenance costs, and align the rail and ferry operations. These changes will increase the share of freight transported by rail, delivering improved commercial performance. This also contributes to the Government's wellbeing and net-zero carbon objectives by converting road freight to rail, reducing fleet emissions by 70%, and creating and maintaining employment in Wellington and Marlborough.

KiwiRail will address all of the points raised in your letter through the detailed business case. The overall Project relies upon investment from our shareholder, the ports, and prudent debt funding at serviceable levels. We are actively working on these issues and wish to note the following:

Ferry fleet options

The 2019 decision to procure two large rail-enabled ferries was supported by substantial analysis that demonstrated it delivered the greatest net present value. We anticipate this outcome will be reconfirmed as we progress the detailed business case. This is because the infrastructure requirements (e.g. wharves, linkspans, seawalls) are, ultimately, similar irrespective of the size of the ferries but the projected revenues decrease in proportion to the ship capacity. The larger ships enable greatest revenues, which in turn enable KiwiRail to access appropriate debt financing. The rail-enabled capability unlocks additional revenue by aligning ferry and rail operations, supporting greater emissions benefits for New Zealand.

KiwiRail has also progressed the ship procurement significantly since 2019 on the basis that procuring two large rail-enabled ferries attracted the greatest net present value. The market has been engaged through the competitive tender process to select a shipyard (completed December 2020) and to seek debt finance options (responses received in late February). We have reported on these matters as they have progressed.



Port contributions

KiwiRail is working with the ports and their ownership Councils to ensure the portside infrastructure delivers the resilience and operational performance expected by the ports and their customers (of which we are one). These are partnerships that require negotiation and agreement. KiwiRail is preparing proposals for both ports (and their ownership Councils) to deliver the expected outcomes at lower cost. In Picton, KiwiRail is seeking consensus on the locations of the wharves with the Port and the other customers, consequential redesign of the wharves and infrastructure in line with that consensus, and agreement on a revised budget to deliver this outcome. In Wellington, KiwiRail is seeking consensus with the Port and our competitor on the development of the Kaiwharawhara terminal. [38]

This is necessary to retain the key outcomes while remaining within the funding contributions proposed by the ports.

We understand the need for costs to fall appropriately to each party. To date, [38]

We have demonstrated our ability to drive fair commercial outcomes, for example, through the Main North Line insurance negotiations. Of course, KiwiRail cannot control the funding decisions of the ports and their ownership Councils. We will work with Treasury to consider options that may support the ports to increase their contributions.

Debt funding

KiwiRail understands the expectation of Ministers to debt fund the project as much as is possible given the fleet is a commercial asset. We have gone to market to seek proposals to debt finance the two vessels and responses have indicated strong appetite for the project. The level of financing is dependent on forecast net cash flows from the KiwiRail business required to service annual debt obligations, including the new fleet and the portside infrastructure delivering the operating and resilience expectations.

Whole of life costs

The detailed business case will fully consider the whole of life costs of the project, including those met by other parties. KiwiRail is working to reduce the overall portside costs in Picton and Wellington. At the same time, we will continue to work with the Port owners and transport partners to identify consequential requirements on the transport network to achieve forecast volumes in alignment to the National Land Transport Programme and local government transport budgets.



Thank you again for providing a clear position. We understand that a review of the detailed business case is required before further funds will be released. We will continue to be open and transparent to officials.

We would appreciate an opportunity to present the detailed business case to Ministers in person in June.

Yours sincerely

Sue McCormack
KiwiRail Deputy Chair

Greg Miller
KiwiRail Group CEO

Copied to: Hon Grant Robertson, Minister of Finance
Hon Michael Wood, Minister of Transport
Peter Mersi, Secretary of Transport
Andrew Hagan, Deputy Secretary Commercial and Financial
Ross Copland, Chief Executive, Infrastructure Commission

