



COVERSHEET

Minister	Hon Shane Jones	Portfolio	Regional Economic Development
Title of Cabinet paper	Provincial Growth Fund: Upper North Island Supply Chain Strategy and Northland Rail Investment	Date to be published	10 February 2020

List of documents that have been proactively released

Date	Title	Author
10 February 2020	Provincial Growth Fund: Upper North Island Supply Chain Strategy and Northland Rail Investment	Office of Minister for Regional Economic Development
10 February 2020	Provincial Growth Fund: Upper North Island Supply Chain Strategy and Northland Rail Investment DEV-19-MIN-0339	Office of Minister for Regional Economic Development

Information redacted

YES / NO (please select)

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Chair, Cabinet Economic Development Committee

Provincial Growth Fund: UNISCS and Northland Rail Investment

Purpose

- 1 This paper seeks Cabinet approval to Provincial Growth Fund (PGF) investments in Northland rail. This is a companion paper to the Cabinet paper: Upper North Island Supply Chain Strategy Final Report.

Executive Summary

- 2 The Government announced a \$300 million PGF allocation to regional rail in Budget 2019/20 and in July 2019 Cabinet agreed an investment strategy for the allocation. It approved PGF investments of \$^{Commercial Information} in 4 projects across New Zealand, including \$94.8 million on essential repairs and maintenance to the North Auckland Line (NAL) south of Whangarei. ^{Commercial Information}

- 3 In addition to the UNISCS work, the PGF funded a business case to assess the value of investment in Northland rail. The business case found investment in Northland rail was most beneficial for New Zealand where it enabled a rail-connected Northport that improved the connection of Auckland and Northland within the supply chain, for the benefit of both regions.

- 5 Despite its proximity to Auckland, Northland is poorly connected to the rest of New Zealand with poor service levels and lengthy journey times. As a result, the region does not fulfil its potential as a place to invest in and visit. The state of the current rail network, and its lack of connection to Northport makes rail impractical to use for most purposes. Freight generally travels by road, even where this is not economically efficient.

- 6 Achieving full rail connectivity to Northland and Northport would involve investment of \$^{Commercial Information} over an ^{Commercial Inform} period, broken down as:

- a) Upgrading the North Auckland line including increasing the size of tunnels to allow for IMEX (import-export) containers and re-opening the line from Kauri to Otiria (\$^{Commercial Information}, of which a further \$69.7m is required in 2019-2021 in addition to \$94.8m already committed through the PGF)
- b) Purchasing land for the Marsden Point Line connection (\$40m)
- c) ^{Commercial Information}
- d) ^{Commercial Information}

7 We seek Cabinet agreement to invest in the time critical elements of the Northland rail programme, ie those related to upgrade the NAL to a minimum viable import-export container standard (\$69.7m) and purchasing land for the MPL (\$40m). This would involve PGF investment of \$109.7m. Commercial Information

8 This investment is consistent with the PGF rail investment principles and achieves significant benefits in terms of all of the principles for investment. The investment generates the most significant regional economic development impact of any potential regional rail investment across New Zealand. This is due to the reach of the project across the Northland peninsula and any consequential regional economic development benefits that may flow from the development of Northport.

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Background

10 The Coalition agreement between the New Zealand Labour Party and New Zealand First [CO(17)10 refers] includes the goal of a \$1b per annum Regional Development (Provincial Growth) Fund, including:

- Significant investment in regional rail
- Commissioning a feasibility study on the options for moving the Ports of Auckland, including giving Northport serious consideration
- Other large-scale capital projects

12 The Government established the Provincial Growth Fund in November 2017. A core element of the PGF's investment portfolio was infrastructure investment, to better connect regions through rail, road and communications. The PGF has now made significant investments in infrastructure, including rail.

13 In February 2018, Cabinet commissioned the Upper North Island Supply Chain Strategy (UNISCS) study. The study looked at the development and delivery of a freight and logistics strategy for the Upper North Island. It considered the three ports in the area and associated rail, roads and other infrastructure, with the goal of creating a robust supply chain over the next 30 years. The UNISCS Working Group released an interim report in April 2019, provided Ministers with an options report in August 2019 and its final report and recommendations were considered by Cabinet earlier in this meeting.

14 In October 2018, Cabinet agreed to an initial tranche of PGF investment in rail and to a set of principles for PGF investment in rail. In Budget 2019, the Government committed \$300 million of the PGF to investment in regional rail. In July 2019, Cabinet approved \$ Commercial Information of projects out of this \$300m allocation

and agreed that decisions related to the unspent balance would be made following receipt of the final UNISCS report and recommendations [DEV-19-MIN-0213 refers].

PGF investment in Northland rail and port

- 15** In October 2018, Cabinet agreed to a set of principles for PGF investment in rail (with a focus on surge regions):
- Meets PGF requirements: contribution to PGF's objectives, additionality, fit with regional economic development priorities, good project management and governance
 - Ensures the durability of rail grows in the regions as a result of investment
 - Can make demonstrable progress on initiatives within the timeframes of the PGF
 - Will have a significant impact on the productivity of the key sectors in the relevant regions
 - Strengthens distribution/logistics hubs that support regions' key sectors and exports
 - Projects enable improved access for communities
 - Where projects are national in scale, can be started in surge regions to ensure they receive benefits early
 - Prioritises regions where key road infrastructure (i.e. state highways) is deleterious and unlikely to receive sufficient funding through the GPS to make substantial improvements to connectivity.
- 16** As directed by Cabinet in July 2019, this paper considers the UNISCS working group's recommendation for rail investment in the upper North Island. KiwiRail faces particular timing challenges in delivering cost effective and timely improvements to Northland rail, so we have brought these considerations to Cabinet without delay alongside the UNISCS report itself. KiwiRail has the opportunity to fully close the NAL once to undertake significant work. If decisions are taken now this can be undertaken and completed in 2020. Otherwise this will occur in 2021. Further, undertaking the two stages of work concurrently reduces the overall costs of the work.
- 17** Making decisions now, ahead of final decisions on the UNISCS recommendations, does raise a risk that we make an investment that does not result in a satisfactory increase in the level of utilisation of the line. However, we consider that this to be an acceptable risk given the level of funding involved and the regional benefits that will be achieved.
- 18** Investing in Northland rail is consistent with the PGF investment principles, achieving improved outcomes for the investment principles. The scale of regional economic development that could be generated by investment in Northland rail is significantly larger than the benefits of distributing the funding in small parcels around rail projects across New Zealand. This is due to the investment enabling:

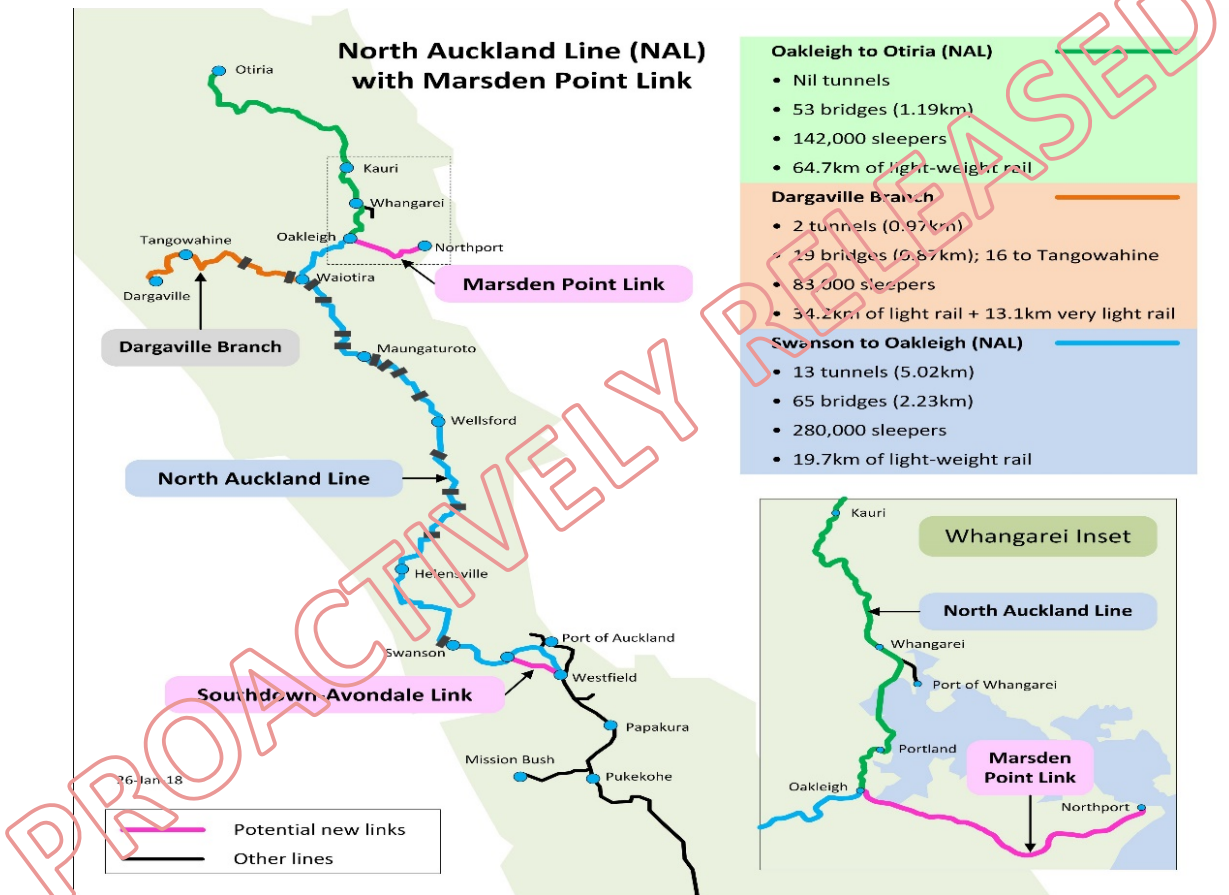
- a) extension of the current reach of NAL into territory that is not currently serviced by rail through the reopening of the Otiria line and so servicing a large part of the Northland peninsular as a whole
 - b) better freight outcomes across the whole NAL line, rather than a small sub-region or subsection of a regional line
 - c) the potential development of Northport and the regional economic development that Northport will deliver
- 19** No other individual regional rail investment or combination of investments would generate the level of change in regional economic development that is possible through this investment.

UNISCS Working Group findings in relation to rail in the Upper North Island

- 20** The upper North Island accounts for over half of the country's population, over half the freight moved and over half the country's Gross Domestic Product (GDP). The UNISCS working group have made recommendations on how the upper North Island ports should be reconfigured to most effectively support future freight and logistics requirements across the region and achieve the greatest value from port and infrastructure assets.
- 21** The working group considers maintaining current arrangements to be very costly and not viable beyond 30 years. It recommends changes be made now to deliver viable arrangements for the future. It recommends Northport be developed to take over much or all of Ports of Auckland's existing and projected future freight business. It recommends the change in port configuration be supported by the development of land-side infrastructure including a rejuvenated North Auckland rail line and spur to Northport; a new inland freight hub to the Northwest of Auckland to complement Metroport in the South of Auckland; and the continuation and potential acceleration of road improvement projects between Auckland, Whangarei and Northport.
- 22** As we noted in the companion paper, we see there are some good strategic arguments to support further examination of a port move from Auckland. Perhaps the most important of these arguments is the potentially significant city-shaping and congestion-reduction benefits in Auckland, the land value gains both on the port site and beyond in Auckland and the regional economic benefits to Northland.
- 23** Northland has limited transport connectivity to the rest of New Zealand, with dependence on State Highway 1 – a long and winding road with areas of medium to high crash risk. The working group recommends investment in both rail and road, but notes its recommended configuration is designed primarily for rail under the principle that roads should predominantly be for people and railways for freight.
- 24** Enhanced rail connectivity would support the movement of freight through Northland. It is likely that the level of freight in Northland will significantly increase in coming years. In its interim report, the working group anticipated the greatest growth in horticulture and agriculture production and freight would come

from Northland in the future, given the mature stage of production in Waikato and the Bay of Plenty.

- 25 The working group recommended upgrading the NAL to modern KiwiRail freight standards (comparable to the rest of the NZ rail network), and capable of managing IMEX freight containers; and connecting the NAL to Northport at Marsden Point through a new Marsden Point Line (MPL).
- 26 The Working Group analysis identified a potential increase of 2,000 jobs in Northland arising from a ports shift.



PGF Business Case on Investment in Northland Rail

- 27 Earlier this year the PGF funded a business case to consider the options for Northland rail including the existing NAL and extension of the network to Northport. The scope excluded freight growth from closure of Ports of Auckland as this was being considered by UNISC. The business case reported that there is a strategic case for the renewal and upgrade of the NAL and the ^{Commercial Information} based on the potential for substantial changes to freight flows within the upper North Island.
- 28 The business case found that the case for investment in NAL was strongest if it included a rail connection to Northport (MPL) and an upgrade of the NAL that would position Northport within the Upper North Island growth triangle. The business case considered that 300,000 containers (TEUs) could be moved between Auckland and Northland by rail each year using single track infrastructure, rather than road. It assessed the benefit cost ratio (national) as

1.19. Over half of the benefits in this scenario arose from decongesting Auckland roads.

- 29** KiwiRail anticipate demand for rail freight would grow beyond this level as NAL became a more regular and reliable alternative to SH1, particularly as the road becomes increasingly congested. KiwiRail has embarked on planning and procurement for the essential repairs and maintenance of the NAL funded by the PGF. The further rail investments recommended by the working group would enable rail to provide a quality full IMEX container alternative to road for the growing freight demand. This would reduce the future freight levels on SH1 and generate benefits in terms of environmental outcomes, congestion and safety.

Benefits and costs of investing in Northland Rail

- 30** The NAL is currently in a degraded state. It is one of the most degraded lines across the Kiwirail network. Following decades of managed decline, it has severe limitations on speed and capacity to accommodate some types of rolling stock as well as being unable to transport standard hi-cube import-export (IMEX) containers. Investment in this capability would increase the value of Northland rail to its customers, particularly importers and exporters.
- 31** With this investment, KiwiRail expect to see greater interest from freight-logistics firms in using rail as many have expressed strong support for this initiative through working groups on the NAL options. Reliability and reduced journey times would enable Kiwirail to increase rail's share of freight for the growing Northland tonnage in, for example, horticulture. This would otherwise be trucked through Auckland and on to export ports, adding to Auckland's congestion and Northland's truck driver shortfall. Processing and packaging industries would be better informed about where to locate to take advantage of road and rail connections.

Regional economic development

- 32** Despite its proximity to our largest economic centre and its rich resource base, Northland continues to lag other regions on employment, income, and wellbeing measures. Strengthening Northland's connectivity will be critical to unlocking the productivity potential of the region and enabling new opportunities for local people and business.
- 33** While the NAL essential repairs and modernisation are substantial programmes, the component parts are relatively straight-forward rail civil engineering, with tunnel widening technologies tested in the Kaikoura recovery. This means the works can be started in early 2020 and substantial elements completed within 12 months. The NAL modernisation programme and MPL would have direct stimulus benefits to Northland through engineering contracts, sub-contracts and jobs. It would also enable Kiwirail to rejuvenate its workforce.
- 34** The economic stimulus that would be generated by the project's procurement in Northland would have a multiplier effect in the wider Northland community. KiwiRail have included a local content weighting in the criteria for tenders of the essential repairs work. This means that funds paid to firms undertaking work such as building bridges, clearance and maintenance work for KiwiRail would be spent in the region.

35 There is scope to undertake further economic activity in Northland without the regional economy overheating and creating inflation. The output gap (the difference between potential production and actual production) in Northland is likely to be one of the largest output gaps across the country. Northland has the highest level of unemployment in the country at 5.8% relative to the national average of 4.2%. This investment would generate jobs in the region and stimulate productivity in the region but, given the output gap, this would be less likely to lead to wage inflation than is the case elsewhere in New Zealand.

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Costs

38 A rail-enabled Northport has a total cost of \$^{Commercial Infor} and will take ^{Commercial Information} to complete. This cost includes the \$94.8m cost for essential repairs and maintenance that Cabinet have already approved. The work involves the following work programmes:

- a) *Upgrading NAL including increasing the size of tunnels and re-opening from Kauri to Otiria:* \$69.7m is required to complete the essential repairs and maintenance of the NAL, increase the size of the tunnels and re-open the northern section of the line from Kauri to Otiria. NAL tunnels are too small to accommodate standard export containers on KiwiRail's wagons. With the exception of the West Coast, no other rail-served province faces this limitation. The scope of work proposed is sufficient to re-open the line for slow moving conventional freight trains north of Kauri and for the line south of Whangarei to be high-cube capable. Over time, the track, bridge and communications assets associated with the NAL will also need to be renewed, given the age of these assets. The cost of this renewal is \$^{Commercial Infor}. This investment will improve the line's performance, bringing it to an equivalent level of performance as lines serving other New Zealand ports. There are choices on timing of this further spending.
- b) *Buying the land for the Marsden Point connection:* Only 25% of the total required land is held by a mix of the Crown, Northland Regional Council or port related companies. All the land required is designated, but it will take at least 24 months to acquire the remaining land through negotiation or compulsory purchase. Purchasing the land preserves the ability of the Government to construct the MPL in the future. KiwiRail estimate acquisition will cost \$40m, including advancing design in selected areas to limit the purchase costs and other impacts that could give rise to

compensation. There are willing sellers already making enquiries about sale.

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Funding

37 We are seeking Cabinet approval to PGF funding of \$109.7m in Northland rail, to cover investment in NAL improvements (\$69.7m) and Marsden land purchase

(\$40m). This would ensure the time critical elements of the work programme could be progressed.

- 38 This investment would enable the IMEX upgrade of the NAL to be undertaken over May to September 2020. KiwiRail will close the NAL only once for this work (including the essential repair work). Delaying decisions on this work until 2020 would mean that KiwiRail could not undertake procurement and design work in time for a shutdown to take place over winter 2020. Work would therefore proceed over winter 2021 and the upgraded NAL would open in November 2021 rather than November 2020. Further, undertaking the two stages of the work concurrently reduces the overall costs of the work. Investment now would also enable Marsden Spur land purchases to be made before prices rise significantly in light of the potential future development of Northport.

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Potential risk with investment

- 40 If the development of a rail enabled Northport (as recommended by the working group) does not proceed there is a risk that this investment is not fully utilised, which would reduce the regional economic development benefits that it would generate. It would still improve rail outcomes in Northland because it would increase the footprint and quality of rail across Northland. However, patronage levels are likely to be significantly lower without a Northport connection. We are comfortable that the proposed level of investment is acceptable in relation to this risk, particularly as the \$40m investment associated with the purchase of Marsden Point land can be regained if Northport does not proceed.

Governance, assurance and capability

- 41 Governance of this investment is undertaken within KiwiRail. KiwiRail have recent experience of managing major capital projects including large scale investment in the Auckland network that was delivered on time and on budget. KiwiRail has management and governance systems for major capital investments and is well placed to manage this project.
- 42 The NAL and MSL projects have objectives related to “NZ Inc” and wider regional economic and social benefits that go beyond KiwiRail’s commercial and delivery imperatives. To provide Ministers with assurance around these aspects of the investment, we have appointed a Provincial Development Unit representative onto KiwiRail’s existing Northland Programme Governance Board. This role can be expanded to include the additional projects approved by Cabinet through this paper.
- 43 KiwiRail already has equivalent governance arrangements with NZTA and Regional Councils for its two Metro Programme Governance Boards. The Government’s representative will ensure these are progressed through the investment process and would facilitate enhanced communication on the programme between KiwiRail as the programme delivery organisation, the PDU, other agencies and Ministers. This PGF funding of KiwiRail is one of a number of Crown funding streams. As part of the Future of Rail programme, Cabinet has agreed (DEV-19-MIN0225 refers) a new planning and funding framework for rail. This provides for public funding of track infrastructure and NZTA advice on these

below rail investments. The current PGF investments into Northland Rail are of a similar “below rail” nature. The current and any further Ministry of Transport contracts for PGF funded track infrastructure provide for this future involvement or oversight by other parties including the NZTA.

44 The Ministry of Transport (for operating grants) and the Treasury (for any equity injection for land) would receive assurance over project and risk management through the funding agreement and reports to be agreed with Kiwirail in line with the agencies’ Memorandum of Understanding for Roles and Responsibilities relating to PGF funding of transport related projects.

45 Since the time Cabinet agreed the NAL phase 1 works, officials have shifted the Crown’s contractual responsibilities for oversight of PGF operating contracts with KiwiRail from The Treasury to the Ministry of Transport. The Ministry will, if Cabinet approves the expenditure in this paper, therefore be responsible for Northland Rail PGF contracts with KiwiRail totalling \$204.5 million. Commercial Information

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Treasury comment

47 A decision on full investment in the North Auckland Line is dependent on decisions Cabinet makes on the UNISCS and the working group’s final report. We have advised, if Ministers wish to make an investment in the interim, the two proposed investments (totalling \$109.7m) are the lowest risk Commercial Information

Consultation

48 Kiwirail and the Treasury have been consulted on this paper. The Department of Prime Minister and Cabinet and NZTA were informed.

Financial Implications

46 PGF funding is expected to be delivered to Kiwirail on the basis of the following principles:

- Investments expected to make a commercial return would be funded by equity injection or debt.
- Investments made in order to deliver a mix of commercial return and wider regional and social development would be funded by operating grant.

- 47 Investment in the NAL will be by way of an operating grant. Investment in land purchase will be made on condition of retaining the Crown's ability to sell the land in the future and return funds to the PGF for regional economic development purposes.
- 48 KiwiRail do not expect to incur further costs as a result of this investment that would require additional funding from the Crown.

Human Rights and Gender Implications

- 49 There are no human rights or gender issues or implications.

Legislative Implications

- 50 There are no legislative implications.

Regulatory Impact Analysis

- 51 A regulatory impact statement is not required for the proposals in this paper.

Treaty of Waitangi Implications

- 52 There are no Treaty of Waitangi implications.

Disability Perspective


- 53 There are no disability implications.

Proactive Release

- 54 This Cabinet paper will be released following announcement of the projects.

Recommendations

The Minister of Regional Economic Development and the Minister of Transport recommend that the Committee:

1. **note** that Cabinet agreed to PGF investment in rail in October 2018 and approved a number of regional rail projects;
2. **note** that \$300 million of the PGF was ring-fenced for regional rail and announced through Budget 2019/20;
3. **note** Cabinet agreed in July to:
 - a) \$128.4 million PGF investment in regional rail projects including \$94.8 million to provide essential repairs and maintenance to the Auckland to Whangarei section of the North Auckland Line, by operating grant, into Kiwirail; and
 - b) Commercial Information 
4. **note** that the UNISC working group has recommended that Northport be developed to take over much or all of Auckland's existing and projected future freight business, supported by a rejuvenated North Auckland rail line and spur to Northport

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- a) upgrading the North Auckland line including increasing the size of tunnels to allow for IMEX (import-export) containers and re-opening the line from Kauri to Otiria (\$^{Commercial Information} in total, \$69.7m in 2019-2021);
- b) purchasing land for the Marsden Point Line connection (\$40m);
- c) Commercial Information
- d) Commercial Information

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- 7. **note** that some investments in Northland require Cabinet decision before the end of 2019 to secure lower costs and faster delivery;
- 8. **agree** to PGF funding of \$109.7m for Northland rail for those time critical investments, including raising NAL IMEX capability (\$69.7m) and purchasing land for the MPL (\$40m).
- 9. **note** that this investment is consistent with the PGF's regional rail investment principles approved by Cabinet in October 2018:
 - a) Meets PGF requirements: contribution to PGF's objectives, additionality, fit with regional economic development priorities, good project management and governance
 - b) Ensures the durability of rail grows in the regions as a result of investment
 - c) Can make demonstrable progress on initiatives within the timeframes of the PGF
 - d) Will have a significant impact on the productivity of the key sectors in the relevant regions
 - e) Strengthens distribution/logistics hubs that support regions' key sectors and exports
 - f) Projects enable improved access for communities
 - g) Where projects are national in scale, can be started in surge regions to ensure they receive benefits early
 - h) Prioritises regions where key roading infrastructure (i.e. state highways) is deleterious and unlikely to receive sufficient funding through the GPS to make substantial improvements to connectivity;

10. Commercial Information

11. Commercial Information



12. **note** that the Ministry of Transport and Treasury will receive assurance over project and risk management through the funding agreement and reports to be agreed with Kiwirail in line with Agencies' Memorandum of Understanding for Roles and Responsibilities relating to PGF funding of transport related projects;

13. Commercial Information



14. Commercial Information



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15. **agree** that the proposed changes to appropriations for 2019/20 be included in the 2019/20 Supplementary Estimates and that, in the interim, the increases be met from Imprest Supply; and

16. **agree** that the Minister of Transport/Minister of Regional Economic Development and the Minister of Finance can jointly approve re-phasing of expenditure between years to align with the timing of the project if required.

Authorised for lodgement

Hon Shane Jones
Minister of Regional Economic Development
Minister of Infrastructure
Associate Minister of Transport

Hon Phil Twyford
Minister of Transport

PROACTIVELY RELEASED