

Chair
Economic Growth and Infrastructure Committee

CLIFFORD BAY FERRY TERMINAL INVESTIGATION 2013

Proposal

1. This paper provides the findings of the Clifford Bay ferry terminal investigation 2013. The investigation found that the Clifford Bay ferry terminal is not commercially viable as a fully privately funded project. I ask Cabinet to either, agree that the Clifford Bay proposal not proceed to the development phase, or, agree that on a national interest basis, the project move forward to the development stage. A decision to proceed would require the Crown to accept, manage and mitigate project risk, and provide full project funding.

Executive summary

2. Clifford Bay is a ferry terminal concept that could replace Picton as the southern end of the Cook Strait ferry crossing. It is estimated that it could be delivered by 2022 at a cost of \$525 million¹. On a road or rail trip from Wellington to Christchurch, Clifford Bay would save 75 and 130 minutes of journey time respectively.
3. In November 2012 the Economic Growth and Infrastructure Committee invited the Minister of Transport to report back with a recommendation on whether or not to proceed to the development stage of the Clifford Bay ferry terminal project. Subsequently, the Minister established an investigation team to thoroughly examine the commercial viability of Clifford Bay as a development requiring minimum investment and risk for the government.
4. The investigation has been completed. A summary of the reasons for the recommendation not to proceed with the development of Clifford Bay follow.
 - 4.1. Avoidable infrastructure investment required at Picton and ferry operator cost savings are significantly below the 2012 estimate.
 - 4.2. Clifford Bay is not commercially viable as a fully privately funded project. This is because it generates insufficient private revenue to provide a normal financial return to private investors.
 - 4.3. To induce private sector investment in the construction and operation of Clifford Bay, a direct government contribution of [REDACTED] between 2014 and 2020 would be required.

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¹ Based on 2012 concept engineering design and costing

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- 4.4. A number of significant risks would exist in the development and operating phase of Clifford Bay. It is expected these would be manageable, but management and mitigation cost could be expected to fall on the government.
- 4.5. The economic case for the project is positive but modest, reflecting that Clifford Bay saves operators and users significant travel time and money. The project has an expected Benefit Cost Ratio of 1.3.
- 4.6. Picton will continue to function as the southern inter-island ferry terminal for the foreseeable future. At Picton:
 - 4.6.1. significant surplus freight and passenger handling capacity exists in the current state;
 - 4.6.2. material freight and passenger handling capacity constraints have not been identified in the 30-year horizon of the analysis;
 - 4.6.3. no government investment is required to maintain the existing function over the next decade;
 - 4.6.4. cost savings from the move to Clifford Bay are significantly less than previously estimated.

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4.7.

5. If the government considered Clifford Bay as public good infrastructure, the significant time and cost improvement it offers to the strategic road and rail networks could be used to mount a reasonable case. In this alternative approach, recovery of toll revenue to offset the cost of construction and operation would be a secondary consideration, and the government would need to fund the entire project cost of \$525 million. I consider that the government cost, the remaining risks, and the lack of compelling constraint at Picton mean this alternative approach should be set aside at this time.
6. The conclusion of the investigation is that the modest economic benefits do not justify a government investment when set against the risks.

Project description

7. Clifford Bay is a Marlborough ferry terminal concept that could replace Picton as the southern end of the Cook Strait crossing - saving operators, major freight users and passengers time and money.
8. On a road and rail trip from Wellington to Christchurch total time savings are estimated at 75 and 130 minutes respectively.

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9. The terminal design concept would provide a two-operator facility designed to serve anticipated freight volumes for at least 50 years.
10. Clifford Bay is expected to cost \$525 million to develop and construct. This is based on concept engineering design developed in 2012. If a decision were taken now to proceed, Clifford Bay could be under construction in 2018 and delivered by 2022.

Background

11. An assessment of the economic and financial feasibility of Clifford Bay was completed by the Ministry of Transport in 2012. That assessment provided an overview and update of the work completed by KiwiRail and its predecessors. The results of this preliminary assessment were positive enough to recommend further work and included the following key points.
 - 11.1. The view that the Picton “status quo” was unsustainable. This was because it was believed that Picton posed inherent and increasing operational inefficiencies, that over time these would lead to inefficient capital expenditure on additional vessels, and that imminent and substantial capital investment on Picton facilities was required.
 - 11.2. The costs of responding to these constraints and inefficiencies at Picton could be avoided in a move to Clifford Bay, and were therefore available as revenue operators and users would be prepared to pay to use Clifford Bay.
 - 11.3. The inherent travel time and operating cost advantages of Clifford Bay also created savings for operators and users that would be available as revenue they would be prepared to pay to use Clifford Bay.
 - 11.4. The view that together these avoided Picton costs and Clifford Bay operating advantages made available enough revenue to fully fund the construction and operation of Clifford Bay, making it possible for a government procurement process to lead to a privately owned and operated ferry terminal.
 - 11.5. A proposal that these findings be tested in a subsequent phase through direct commercial discussion with ferry operators and major freight users.
12. In November 2012 Cabinet invited the Minister of Transport to report back once discussions with ferry operators regarding potential port fees were concluded, with a recommendation on whether to proceed to the next stage of procurement.
13. This led to the formation of the 2013 investigation to thoroughly examine the commercial viability of Clifford Bay as a development requiring minimum investment and risk for the government.
14. A detailed report on commercial viability (Clifford Bay Investigation 2013) was prepared by the Ministry of Transport with assistance from the Treasury and the New

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Zealand Transport Agency. This Cabinet paper draws on the commercial viability report.

Investigation approach

15. An analytical framework was developed to assess the financial and economic cases for Clifford Bay. The primary objective was to determine if Clifford Bay could be built and operated using private sector funding and capability. This involved developing a clear commercial understanding of both Picton and Clifford Bay.
16. A long-range forecast of demand was developed for freight and passenger movements across Cook Strait.
17. The potential savings for ferry operators and freight users, such as avoided Picton costs, reduced fuel cost and travel time were then identified.
18. Commercial discussions were held with the two ferry operators and rail freight to see how much of the savings, taking account of risk, they were willing to pay in increased port fees. Alongside this, the direct cost savings for road freight were identified. This gave an estimate of the four streams of revenue available to the constructor/operator of Clifford Bay.
19. The financial case assessed the port fees available from operators and users and the construction and operational costs of Clifford Bay. It looked at whether Clifford Bay would generate an adequate commercial return for the private sector to fund, develop and operate the ferry terminal.
20. The economic case complemented the financial case, and took a broader view of the potential benefits of the project from the perspective of the economy as a whole.

Key findings of the investigation

Demand

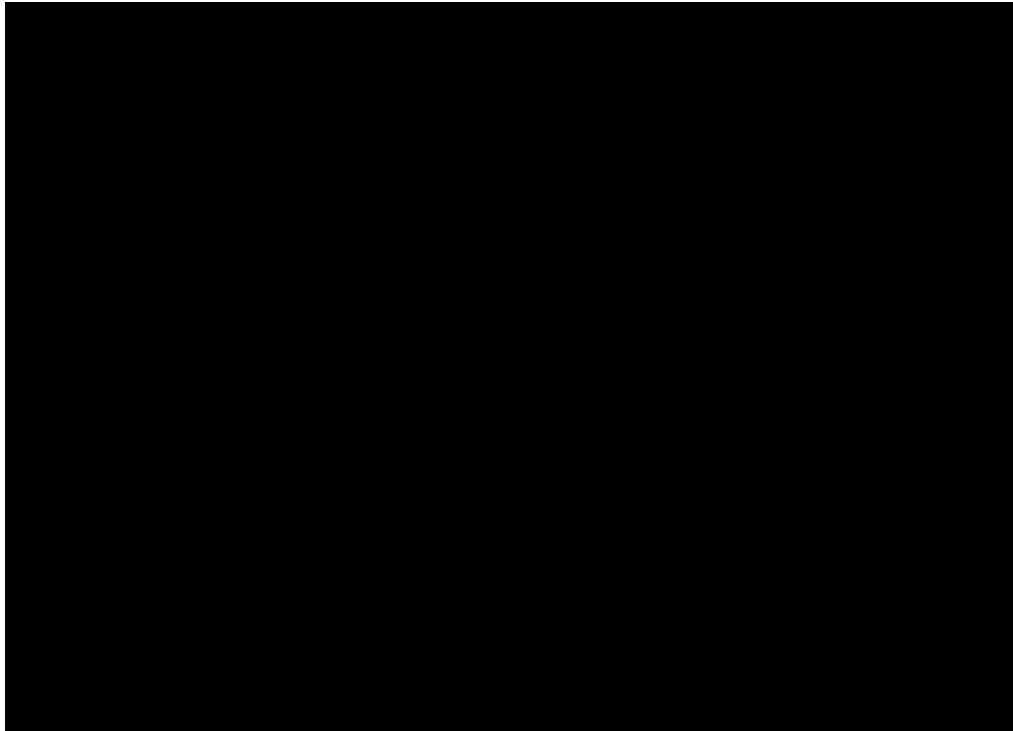
21. The Cook Strait freight market is part of the broader inter-island freight market which comprises three modes - coastal shipping (generally containerised freight carried between regional ports such as Tauranga and Lyttelton) as well as road and rail freight carried on the inter-island ferries. The inter-island freight market is forecast to grow by 61% by 2040. All modes are expected to grow at a similar compound annual growth rate of just under 2% per annum over the long term.
22. The Clifford Bay investigation has identified that the Cook Strait passenger market has declined significantly in recent years and is predicted to exhibit little, if any, growth going forward. This is a result of increased competition from air travel and changes in travel patterns of international visitors to New Zealand. The benefits of Clifford Bay for the passenger market vary depending on the origin or destination of travel in the South Island.

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Commercial viability assessment

23. The investigation has found that the port fee revenue available from operators and users is below the estimate made in 2012, and well short of the level required to induce private investment. The breakdown of this total port fee revenue pool is shown in the following pie chart.

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24. In 2012, the Benefit Cost Ratio was estimated to be 1.9. The main reasons for the reduction to 1.3 are:

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Withheld pursuant to Section 9(2)(b)(ii), 9(2)(ba)(i)

24.1. the capital expenditure requirements at Picton have reduced significantly, from an estimated [REDACTED] in 2012 to around an estimated [REDACTED] in 2013

24.2. cost savings to ferry operators are significantly below the levels estimated in 2012.

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25. The present value of all costs in the construction and first 25 years of operation is estimated to be \$314 million, while the present value of all revenue for that same period is estimated to be [REDACTED]. This would give a net present loss of [REDACTED] for the project as viewed through the lens of a private investor.

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26. The financial analysis therefore shows that Clifford Bay cannot be delivered using only private funding. That is because it would generate insufficient revenue to provide a normal financial return to private investors.

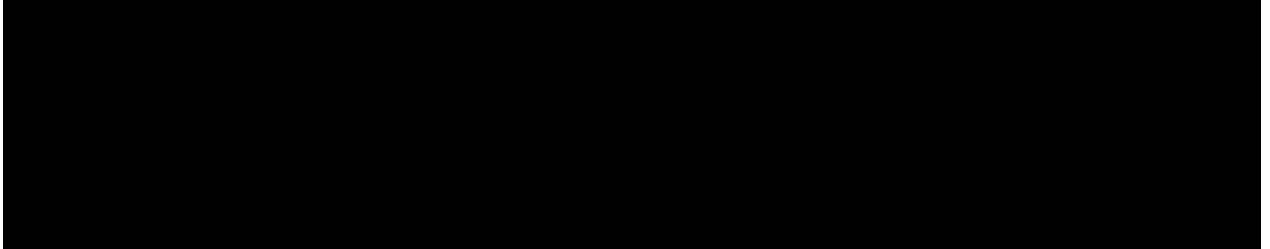
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The potential role of government - direct investment (nominal dollars)

27. The project would only be able to move to consenting and procurement if the government was prepared to play a direct investment role in project development² and delivery that totals [REDACTED] between 2014 and 2020.

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Estimated government direct investment requirement for Clifford Bay to proceed



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The potential role of government - risk

28. If the project proceeded, the government would also be required to manage and mitigate risks in both the development phase and the operating phase.
29. In the development phase the government's risk is medium to high, and includes the following.
- 29.1. Major civil engineering project development risks such as those inherent in consenting in the coastal and marine environment, negotiating and securing the required land, and the procurement process.
- 29.2. Negotiating binding port fee agreements with ferry operators at the required level, without conditions that undermine planning confidence, and without creating an unintended impact on the competition between ferry operators.
- 29.3. [REDACTED]

30. In the operating phase the government's risk profile is medium, and includes the following factors identified in 2012 market soundings as critical roles for government.

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² Project development involves gaining resource consent, securing the required land access and property rights, commercial negotiation with operators and users and the planning and delivery of the procurement process.

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30.1.

30.2.

Current state of Picton facilities

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31. The investigation found that the Picton facilities are not expected to fundamentally fail or move into constraint due to asset age/condition or growth in freight volumes during the period of analysis (30 years). It also identified that the level of investment required at Picton over the next decade to extend life and adapt facilities is around [REDACTED]. This cost would be met by Port Marlborough, ferry operators and users.

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32. This means that the Picton status quo is sustainable, and that a decision to build Clifford Bay should be considered an investment in substantially reducing the time and cost involved in moving freight and passengers across Cook Strait. It is not an investment that is necessary to meet medium term demand expectations or relieve a significant network constraint.

33.

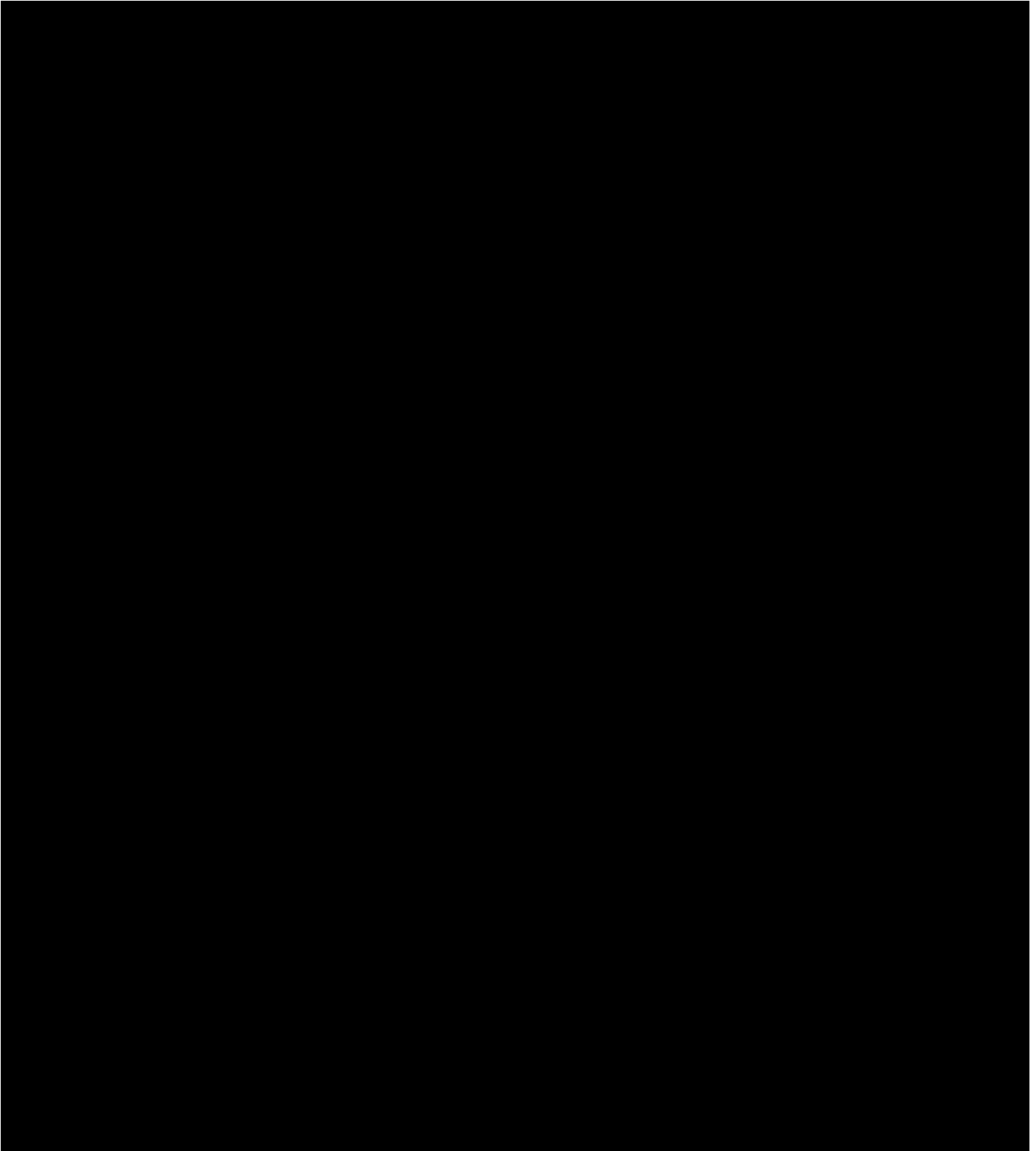
Economic case

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34. When assessed using a methodology very similar to that used by the New Zealand Transport Agency to assess investment in roads, the Clifford Bay project produces an economic surplus with a net present value of \$108 million and a Benefit Cost Ratio of 1.3. Wider economic benefits with a net present value of \$37 million have also been identified.

35.

Withheld pursuant to Section 9(2)(b)(ii), 9(2)(ba)(i)



Withheld pursuant to Section 9(2)(b)(ii), 9(2)(ba)

The alternative of fully publicly funded delivery

36. If the government considered Clifford Bay as public good infrastructure, the significant time and cost savings it offers to the strategic road and rail networks could be used to mount a reasonable case for proceeding using full government funding.
37. In this approach, recovery of toll revenue to offset the cost of construction and operation would become a secondary consideration. Once the government decided to build Clifford Bay on the basis of the economic case, the commercial imperative on operators and users to contribute would diminish significantly. The government would therefore need to fund the entire project cost of \$525 million. Revenue from operators and users would likely be sufficient to meet operating costs once the facility was operational, and possibly contribute to repayment of capital invested.
38. Several of the key risks would remain. In the development phase the government would continue to be exposed to the usual major project development risk, [REDACTED] In the operating phase, exposure to variation in freight and passenger volumes would continue. Withheld pursuant to Section 9(2)(b)(ii), 9(2)(ba)(i), 9(2)(g)(i)
39. Finally, while the opportunity for operating cost and time travel savings is significant, the lack of compelling constraint at Picton for the foreseeable future means:
- 39.1. Picton is an acceptable status quo that will perform the required role with relatively low levels of third party investment requirement
- 39.2. the option to revisit Clifford Bay and make a fresh assessment in 20 or 30 years remains open, and is not foreclosed or made more difficult by electing the status quo at this time

Consultation

40. The key findings of the Clifford Bay Investigation 2013 have been discussed with the State Services Commission, the Office of Treaty Settlements, the Ministry of Business, Innovation and Employment and the Department for Prime Minister and Cabinet.
41. The conclusions and recommendations of this paper have been discussed with the Treasury and the New Zealand Transport Agency.

Financial implications

42. There are no implications.

Human rights, gender, disability perspective or legislative implications

43. There are no implications.

Regulatory Impact Analysis

- 44. No regulatory impact analysis is required.

Publicity

- 45. There is keen interest in the project.
- 46. A decision not to proceed should be communicated in a manner that provides stability and planning confidence for Marlborough communities.
- 47. Preceding the announcement I intend to meet with Port Marlborough and the Marlborough District Council to more directly inform them of the outcome of this year's commercial viability work.
- 48. Appropriate debrief engagement would also occur between the investigation team and ferry operators, major freight users, and other key stakeholders immediately ahead of the announcement.
- 49. Once the key parties are briefed, I will issue a press release and provide an interview in Blenheim with the local newspaper – The Marlborough Express. I am planning for this to occur in November 2013.

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Recommendations

50. It is recommended that the Committee:

1. **note** that the investigation has thoroughly examined the commercial viability of Clifford Bay as a development requiring minimum investment and risk for the government, in response to EGI Min (12) 23/1
2. **note** that in the context of the scope of the investigation, the conclusion is that the Clifford Bay ferry terminal project is not commercially viable as a fully privately funded project, and that the modest economic benefits do not justify a government investment when set against the risks
3. **EITHER**
 - (a) **agree** that the Clifford Bay ferry terminal project should not proceed to the development phase
 - (b) **agree** that the decision not to proceed would be communicated in a manner that provides stability and planning confidence for Marlborough communities
4. **OR**
 - (a) **note** the alternative approach of considering Clifford Bay as a fully publicly funded infrastructure opportunity
 - (b) **agree** that the project move forward to the development stage on a national interest basis, in clear view of the Crown requirement to accept, manage and mitigate project risk, and provide full project funding
 - (c) **note** the future requirement for a new Crown appropriation of around \$36 million for the development phase over the period 2014 to 2018, and around \$500 million for the construction phase over the period 2018 to 2022
 - (d) **note** that papers outlining the scope, nature and timing of the appropriations, and the financial and other implications, would be provided to the Cabinet Economic Growth and Infrastructure Committee for approval in due course
 - (e) **agree** that the decision to proceed to the development stage would be communicated in a manner that provides Marlborough communities with a reasonable understanding of approach and timeframe

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5. **agree** that this Cabinet paper be released to the public with sensitive commercial information redacted

Hon Gerry Brownlee
Minister of Transport

Dated: _____