Port Marlborough

Ferry Precinct Development Business Case

Commercially sensitive and privileged

24 November 2021

Prepared for Marlborough District Council Holdings

EXECUTIVE SUMMARY

This business case seeks shareholder approval for a major transaction, under the Companies Act 1993, in support of $110 million investment to upgrade Waitohi-Picton ferry infrastructure to accommodate the new Interislander ferries as part of KiwiRail's Inter-island Resilient Connection (iReX) project. It also requests a funding application be made to the Marlborough District Council for debt provision of $110 million.

Port Marlborough's (PMNZ's) Board approved the proposed investment, contingent on shareholder approval, on the following grounds.

The Cook Strait crossing is a strategic national asset, extending State Highway One and the main trunk railway between the North and South Islands and is vital to New Zealand transport and tourism infrastructure.

Overall the iReX project has a $1.45 billion budget and involves the upgrade of the Interislander ferry fleet and the redevelopment of port facilities in both Waitohi-Picton and Wellington.

KiwiRail's Interislander ferries are at the end of their working lives, and a replacement programme has become critical. KiwiRail has entered into a contract with Hyundai to supply two new larger rail-enabled ferries in mid-2025.

PMNZ's ferry infrastructure is reaching the end of its economic life, and the new vessels require replacement.

In Waitohi-Picton, the precinct's redevelopment involves the construction of a new wharf, a new ferry terminal building, a carpark, changes to the rail, and vehicle marshalling areas and roads surrounding the port. Total project costs are estimated at close to $360 million.

PMNZ is seeking to debt finance $110 million through the Marlborough District Council (MDC) facility to own:

1. Port strategic assets – 'wet assets' such as the wharf, dredging, and marine infrastructure.
2. Improvements on PMNZ land – land-side improvement to car parking seawalls etc.

In return, KiwiRail would enter a 60-year contract (30+30), with an agreed methodology for fee-setting based on the Commerce Commission Input Methodology that would allow:

- A sustainable return based on a WACC with an asset beta of ....., biennially adjustable according to the risk-free rate and debt risk premium
- A clear method to recover operational and R&M costs

PMNZ has agreed various measures to significantly de-risk its position during construction and over the lease and licence.

The current deal as negotiated provides an opportunity to cement a key commercial relationship with a 60-year agreement. It is a once-in-a-generation opportunity to review the ferry infrastructure and its integration to Picton. It also secures long-term sustainable and growing dividends to the shareholder.

We **recommend** Marlborough District Council Holdings:

- Approve the proposed major transaction and capital investment of $110 million to acquire new ferry precinct assets
- Seek to secure debt funding for the project via its sole shareholder Marlborough District Council (MDC).

1. BACKGROUND

1.1 Governance Structure of Port Marlborough

PMNZ is a port company, under the Port Companies Act 1988, reporting to its sole shareholder the Marlborough District Council Holdings (MDCH) company. MDCH in turn reports to its sole shareholder the Marlborough District Council (MDC).

A major transaction is defined in the Companies Act 1993, under clause 129 (2) (a), as the acquisition of, or an agreement to acquire, whether contingent or not, assets the value of which is more than half the value of the company's assets before the acquisition.

PMNZ's total assets are anticipated to be close to $205 million by June 2021. The proposed investment of $110 million therefore requires shareholder approval as a major transaction.

PMNZ intends to debt fund the project. One of activities the MDCH undertakes is to:

"Obtain financing for its subsidiaries and Parent at the most attractive commercial rates available."

This business case, therefore also seeks MDCH approval to approach MDC for debt funding of $110 million.

1.2 Settlement Agreement

PMNZ has been negotiating with KiwiRail for several years over the delivery of new infrastructure to service new ferries now due to arrive in 2025.

The framework for these negotiations came via a Settlement Agreement signed in 2017, which resolved a dispute over the setting of fees for the second 12-year term of KiwiRail's current contract. The existing contract had no method for determining the fees in the future, and arbitration was the only contractual mechanism provided for dispute resolution.

The parties resolved the dispute to focus on the future requirements of the Interislander operations by signing a Settlement Agreement.

The key terms of the Settlement Agreement were:

- KiwiRail agreed to pay PMNZ a fixed fee of $5m plus GST for three years ending 31 October 2020
- The annual charge for the balance of Term 2 was to be determined by arbitration or agreed upon as part of a redevelopment agreement for new facilities
- Fees for the proposed new facilities were to be based on the Commerce Commission's input methodology to calculate a fair return on the port's capital, including the exclusion of any stranded asset fee and revaluations

The Settlement Agreement has subsequently been extended to 2024 and links the fee to CPI. As part of this proposal, the fee agreement will continue until the new facilities, are constructed irrespective of any demolition of the existing assets.

The rationale behind PMNZ entering into the Settlement Agreement was to:

- Avoid arbitration

- Secure higher revenue during Term 2
- Focus on the future. PMNZ was aware that its aging infrastructure required investment at some point in the future irrespective of fleet changes
- Avoid future disputes and create certainty by basing the fee on an accepted framework
- Avoid future Commerce Commission scrutiny by dealing with stranded assets and revaluations transparently

It is the first agreement that provides a framework for a focused redevelopment of facilities in Picton and has successfully set the platform for negotiation while securing the higher term identified.

1.3 Building Block Methodology

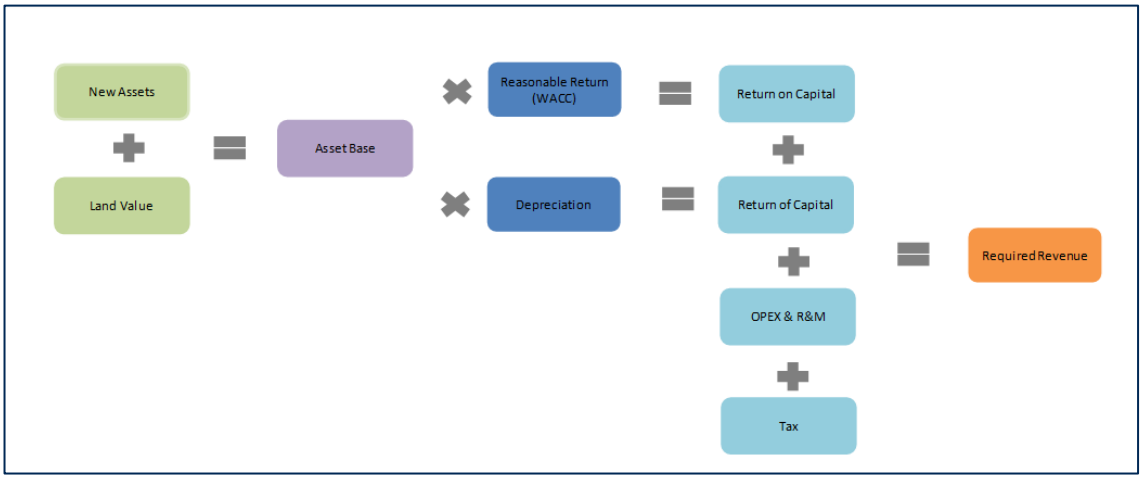
The Commerce Commission does not have a port-specific input methodology, and there are variations in how the building blocks methodology is applied across different sectors. As such, PMNZ interprets the requirement of the Settlement Agreement broadly as the fee is consistent with the logic and key principles of the Commerce Commission approach to regulated industries.

The Commerce Commission building blocks methodology is an approach to calculating a reasonable cost of service that the infrastructure owner should be allowed to recover. The main principle applied by the Commerce Commission is NPV=0; that is, the infrastructure owner should be allowed to cover the full cost of the service, including return on and of capital, but no more. The Commerce Commission calculates NPV=0 using the weighted average cost of capital (WACC) as the discount rate.

The building blocks of the NPV calculation include:

- The initial capital outlay
- The cost of debt and the cost of equity, which together with an appropriate leverage assumption constitute WACC
- The depreciation profile (in the Commerce Commission's regulatory model, depreciation is a financial concept relating to the rate at which capital is returned, rather than a physical concept relating to the expected life of the assets, although the two can coincide)
- Provision for OPEX
- Tax provision.

Schematic 1: IM Building Block Framework



The Commerce Commission periodically publishes the Input Methodologies specifying certain WACC parameters that apply across all sectors (the market risk premium and the data references for calculating the risk-free rate and debt risk premium). It also publishes sector-specific WACC parameters for airports and gas, electricity, and telecommunications networks (including asset beta, leverage, and the debt credit rating assumption).

The Commerce Commission also sets out a standard simplified financial model, ensuring that the Commerce Commission used all building blocks coherently to achieve NPV=0, which is particularly relevant for asset revaluations and the treatment of tax and inflation to avoid double counting.

1.4 A Stage and Gate Framework

Subsequently to the Settlement Agreement, PMNZ and KiwiRail entered into Phase Development Agreements. The Phase Development Agreements set out a staged, documented process for the project's development and the conduct of negotiations. These agreements were recorded under a Phase 1 Development Agreement dated 9 July 2019 (P1DA), a Phase 2 Development Agreement dated 19 June 2020 (P2DA), and a Phase 3 Development Agreement (P3DA) dated 25 November 2020.

These agreements set out:

- A structured negotiation process, setting out escalations and arbitration in the event negotiating teams could not reach an agreement
- The requirement for mutual agreement on the Minimum Viable Product (MVP), which was an important tool for PMNZ to ensure that KiwiRail did not use its bargaining power to resile from the key quality, environmental, and community undertakings made by it
- Structured approval gateways, to ensure an orderly and logical process of negotiations and to minimise the risk of points being re-litigated once key agreements are reached. While the negotiations were based on the assumption that nothing is agreed until everything is agreed, the gateways assisted in maintaining negotiating discipline. This became particularly important in early 2021, when KiwiRail entered the Design Sprint process following realisation that the project was becoming unaffordable. The gateways set out in P3DA were:
  - Gateway 1: Concept Design
  - Gateway 2: Programme and Asset Allocation
  - Gateway 3A: Strategic Procurement Plan
  - Gateway 3B: Approval of Key Terms by respective Boards
  - Gateway 4: Approval of PMNZ funding by MDC
  - Gateway 5: Procurement and award of construction contracts.
  - Gateway 6: Enter into Comprehensive Redevelopment Agreement

Negotiations have been completed up to and including Key Terms (Gateway 3B), providing a clear investment proposal.

This business case is to secure approvals necessary to proceed with funding (Gateway 4).

2. STRATEGIC CASE – REASONS FOR CHANGE

2.1 National Significance of Cook Strait Connection

The first railway in New Zealand was constructed in 1862. One hundred years later, the first roll-on roll-off rail and vehicle ferry began service between Waitohi-Picton and Wellington in 1962. Ferries have been in-service in Picton for close to 60 years, with a rail connection being an important component of that service from inception.

The Cook Strait ferries are extensions of State Highway 1 and the main trunk line, linking road and rail networks between the North and South Islands.

The importance of the Cook Strait ferries to New Zealand's economy cannot be understated. As a nation of two main islands, New Zealand relies on international shipping for both import and export trades. The largest import and export ports (Auckland and Tauranga, respectively) are on the North Island, resulting in much of the domestic freight being amalgamated there. This is particularly true of fast-moving consumer goods, which are then moved south by rail or road on a just-in-time basis. New Zealand's geography means that those goods necessarily go across the Cook Strait as the most efficient route to market (whether by road or rail from there on).

The Cook Strait crossing is, therefore, a strategic national asset connecting the North and South Islands providing the vital key to New Zealand's freight, transport, and tourism infrastructure.

The ferries are also significant economically for the Marlborough region and Upper South Island more generally. For example, the New Zealand Trade and Enterprise regional assessment for Marlborough highlights international visitors and the important linkages to Marlborough's core strengths in the wine and hospitality sectors.

Each year, the Cook Strait ferries operate over 6,000 services, transports over one million passengers, 400,000 cars, and up to 3 million lane metres of freight. These numbers are forecast to increase. They also provide a tourism experience bringing in money, visitors, and supporting jobs in Waitohi-Picton.

By 2052, freight tonnage in New Zealand is expected to increase by more than 40 percent, and KiwiRail sees the rail network playing a role in supporting this growth.

2.2 Reason for Change 1: KiwiRail Retonnage of Fleet Change

The need for a new port and supporting infrastructure is KiwiRail's reason to re-tonnage (or purchase two new custom-built ferries). KiwiRail currently has three Interislander ferries of different sizes, ages, and configurations.

The current Interislander vessels are all reaching the end of their 30-year working lives. They are increasingly facing problems meeting reliability targets, high carbon emissions, and sub-standard crew conditions. On top of that, repairs and maintenance costs are increasing, and the current fleet provides no capacity for growth or increased profitability.

KiwiRail states that the Interislander part of the connection is at risk in its business case for new ferries.

Government policy statements directly influence KiwiRail as it is a state-owned enterprise. The New Zealand Rail Plan released in 2021 is Government's most recent policy statement on rail. It states that the long-term vision is for New Zealand's rail network to provide modern transit systems in the largest cities and to enable increasing volumes of freight to be moved by rail. Stating:

Enabling alternative transport options for people and freight is a key part of providing a multi-modal transport system. Increasing the use of lower-emission transport options, including rail, is an important step in the Government's response to the climate emergency. Supporting increased use of rail will be a part of the changes needed for transport to meet the draft emissions budgets proposed by the Climate Change Commission. This will help to achieve the Government's objective of net zero emissions by 2050. By moving more people and freight onto rail, our roads will also be less congested and safer.

KiwiRail has interpreted this position as a long-term move to rail and purchased two new rail-enabled ferries to replace the existing fleet.

The Hyundai shipping yards in South Korea are currently designing the two new ferries ordered in June 2021. The new ferries are larger than the existing ferries and require a change to port infrastructure to accommodate them.

2.3 Reason for Change 2: Aging Port Infrastructure

Notwithstanding the primary driver for change above, it is useful to consider that the PMNZ terminal assets are also nearing the end of their economic lives. Built in the 1960s and 1970s, they were designed for smaller vessels than are currently operated by InterIslander. The first roll-on roll-off ferries to call Picton was the 4,160GT Aramoana compared to Kaitaki or Kaiarahi today of 22,000GT.

The existing wharves are proving more difficult to maintain and are not considered sufficiently resilient to damage from operational or natural events. The reality is that the wharves are coming to the end of their economic lives, and replacement would be necessary at the end of the current contract (2029).

2.4 Reason for Change 3: A sustainable and greener solution

The iRex project has a strong focus on sustainability and environmental outcomes. This supports both KiwiRail's objectives to reduce its carbon emissions and Port Marlborough's vision is to lead the way as an environmentally restorative port. There are two prime examples on how sustainability and greater environmental outcomes are achieved:

- One of the key design requirements for the new ships is energy efficiency and reduction of carbon emissions:
    - The new ships are specifically designed for the Sounds environment and while larger and faster produce less wake the existing vessel.
    - The vessels will comply with MARPOL Annex VI provisions and will be powered by diesel electric engines that have the capacity to be converted to future cleaner fuels as they become available in NZ. The vessels are also designed to operate on battery power while manoeuvring in the harbour and berthing. This will reduce both noise and air emissions in Picton harbour. While berthed at the port the vessels will be supported by on-shore power.
    - Overall KiwiRail estimate that the new vessels will reduce Interislander's carbon emissions by 40% from day one.
- The supporting infrastructure is also design along sustainable lines:
    - The project will use Infrastructure Sustainability Council of Australia (ISCA) ratings to measure performance against environmental goals with a minimum target of 'excellent' rating
    - The new terminal building will be ring-fenced in its use of ISCA ratings ensuring wider project benefits are not used to offset the building's environmental design.
    - Improved stormwater collection has been included in the design as has recognition of Waitohi awa and the history of the site will be expressed in conjunction with Te Ātiawa.

2.5 Reason for Change 4: Commercial Relationship

New Zealand's rail assets were re-nationalised in 2008, with KiwiRail taking over the operation of rail, track, and the ferry business. The existing contract with Toll was assigned to KiwiRail, with the first term ending in 2017.

KiwiRail is the largest operator on the Cook Strait and PMNZ's largest customer. KiwiRail operates around 3,800 services, transports about 850,000 passengers, 250,000 cars, and up to $14 billion worth of freight. Overall, KiwiRail accounts for 16% of PMNZ's business.

However, the relationship with KiwiRail has not been plain sailing, with many disputes occurring over time, most notably over Clifford Bay and fee setting for the second term of the existing contract.

The context to the current negotiations are as follows:

- In 2005, Toll signed a 12 year deal with PMNZ with a right of renewal for a further 12 years. In the negotiations, PMNZ and Toll agreed to reduce the proposed fees preventing Toll from investigating alternative South Island ferry ports.
- In 2010, KiwiRail wrote to PMNZ to advise that they were actively looking at moving the ferry operations to Clifford Bay and claimed the clause was unenforceable. The threat of the relocation of KiwiRail's Interislander service led to a stagnation of the local economy as investments by local firms (including PMNZ) were put on hold while deliberations were taking place. This was resolved in 2013 as the Government announced the Clifford Bay relocation was unviable.
- In 2016 KiwiRail and PMNZ entered into a dispute over the renewal of the second 12-year term. Central to the discussions was the value of PMNZ assets. KiwiRail claimed that PMNZ's assets were fully depreciated, while PMNZ valued those at Optimised Depreciated Replacement Cost. The contract had no method for determining the fees in the future, had no provision for CPI or any new operational costs that accrued during the term, and left both parties frustrated. Arbitration was the only mechanism provided in the contract for dispute resolution, and with both parties around $2M to $3M apart on the fees, this seemed inevitable. However, the parties resolved this dispute by entering into the Settlement Agreement.

This situation has led to a commercial relationship of distrust and uncertainty, with both parties frustrated in making operational and long-term investment decisions. There has also been spill over to the wider Marlborough economy, with associated businesses facing similar levels of uncertainty.

As negotiated, the current deal provides an opportunity to cement this relationship with a 60-year Contract, anchoring KiwiRail to the region while having new fit-for-purpose facilities and an agreed methodology for dealing fee setting and disputes.

2.6 Conclusion

PMNZ plays a vital link in New Zealand's supply chain by providing infrastructure for Cook Strait ferries.

KiwiRail is PMNZ's largest customer, and the Interislander ferry service substantially contributes to the region's prosperity. KiwiRail has moved to replace its aging Interislander fleet with two new rail-enabled vessels that require upgrades to the infrastructure at both sides of the Strait.

The upgrade of infrastructure at Waitohi-Picton is of national significance, provides better environmental outcomes and is a must-do project for KiwiRail and PMNZ.

3. THE PROPOSED PROJECT

3.1 Overview - The iReX Project

The decision by KiwiRail to re-tonnage the Interislander fleet necessitates major investment in:

- New vessels
- Upgrades to infrastructure in Wellington
- Upgrades to infrastructure in Waitohi-Picton

Overall, this project is called the Inter-island Resilient Connection (iReX) project and has a budget of over $1.4 billion.

The total upgrades to infrastructure required in Waitohi-Picton is estimated at $358.5 million. To be clear, PMNZ's proposed contribution is only a portion of that amount. However, it is useful to understand the Waitohi-Picton Ferry Precinct Redevelopment as a whole.

3.2 Waitohi Picton Ferry Precinct Redevelopment Project

The project will comprehensively redevelop the Waitohi-Picton ferry precinct and associated infrastructure to accommodate new Interislander ferries. The precinct's redevelopment will involve the construction of a new wharf, a new ferry terminal building and carpark, changes to the rail and vehicle marshalling areas and roads surrounding the port.

The concept design (Gateway 1) has been completed. It meets the requirements and intent of the already acquired Resource Consent and achieves agreed key strategic outcomes and operational requirements.

The concept design is based on the following:

- Design Ships: two vessels of 220m LOA x 30.8m beam and 50,000 GT
- Design Trains: two rakes of 20 x 60' wagons
- Health and safety in design such that levels of safety in operations are maintained or improved
- Operational efficiency: achieving 60-minute ship turnarounds
- Sustainability: demonstrating sustainability leadership and net restorative environmental gains, measured against the ISCA framework
- Business continuity: low disruption to current PMNZ and KiwiRail operations and customers during construction and for 'final state' operations
- Whole-of-life design principles
- Iwi, community, and stakeholders' commitments are upheld
- PMNZ master plan outcomes are enabled

A formal agreement of the concept design with KiwiRail was achieved in signing off Gateway 1 of the P3DA. Gateway 1 is formally documented through recording the following:

- Above strategic outcomes and operational requirements
- Minimum Viable Product (MVP), which is a high-level description of key agreed criteria for the design

- Concept Design Drawings that provide sufficient detail to define the layouts and "look and feel" of the design

These records will form part of the Comprehensive Redevelopment Agreement, which deals with the construction period until completion.

3.3 Marine Works

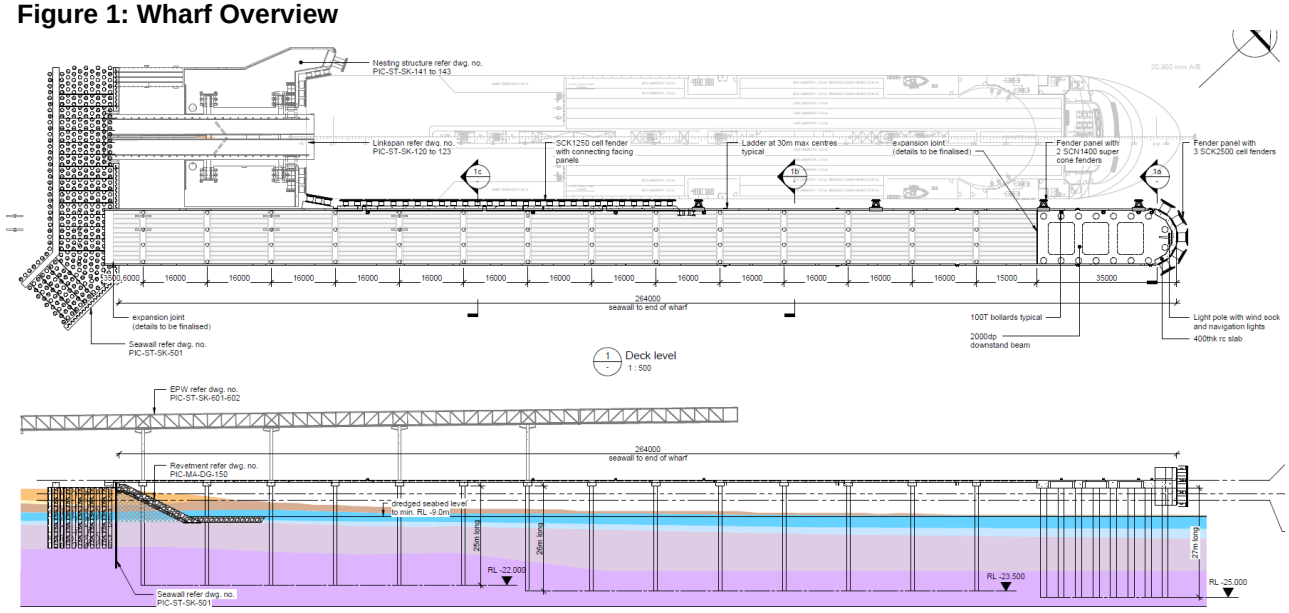
The proposed new structures within the marine area will include a new wharf for the new Interislander berth on the west side and a potential cruise ship berth on the east side. For clarity, the development of the cruise ship berth is excluded from this business case and will be a separate decision to be considered in the future.

The new wharf structure will be 264m long, approximately 100m longer than the existing wharf. The wharf will be 14m wide over its full length, sufficient to allow for maintenance vehicle access and cruise operations.

The new wharf will be constructed in the same location as the existing Number 1 Long Arm as a piled structure with a concrete deck. To provide resilience to sea-level rise, the top of the wharf deck will be approximately 1m higher than the existing wharf. Mooring and fendering facilities will be installed for the ferry berth. Additional work to make the eastern side of the wharf usable by PMNZ is being considered, but again is outside the scope of this business case.

The wharf will be a resilient design to meet the importance Level 4 (IL4) criteria under the building code, with the capacity to withstand major earthquakes with reasonably minimised repair time to return to operation. The design will also consider the demanding ferry operations and timetable through design enabling minimal maintenance and whole of life costs.

Figure 1: Wharf Overview



A linkspan will be constructed, connecting the land and the ship, allowing for vehicle and rail loading/offloading. The linkspan will be a 2-level structure, with road loading on the upper level and rail on the lower. It will comprise a steel structure with hydraulic controls for raising and lowering upper and lower ramps.

An elevated passenger walkway will be constructed from the terminal building and along the wharf for passengers to enter and exit the ships from the upper decks to the ferry terminal building.

A temporary linkspan adaptor structure will be installed at the Aratere berth which will enable all existing Interislander vessels to berth there during construction.

Dredging will be required for the precinct redevelopment to create the berth pockets for ships on either side of the wharf and the new seawalls.

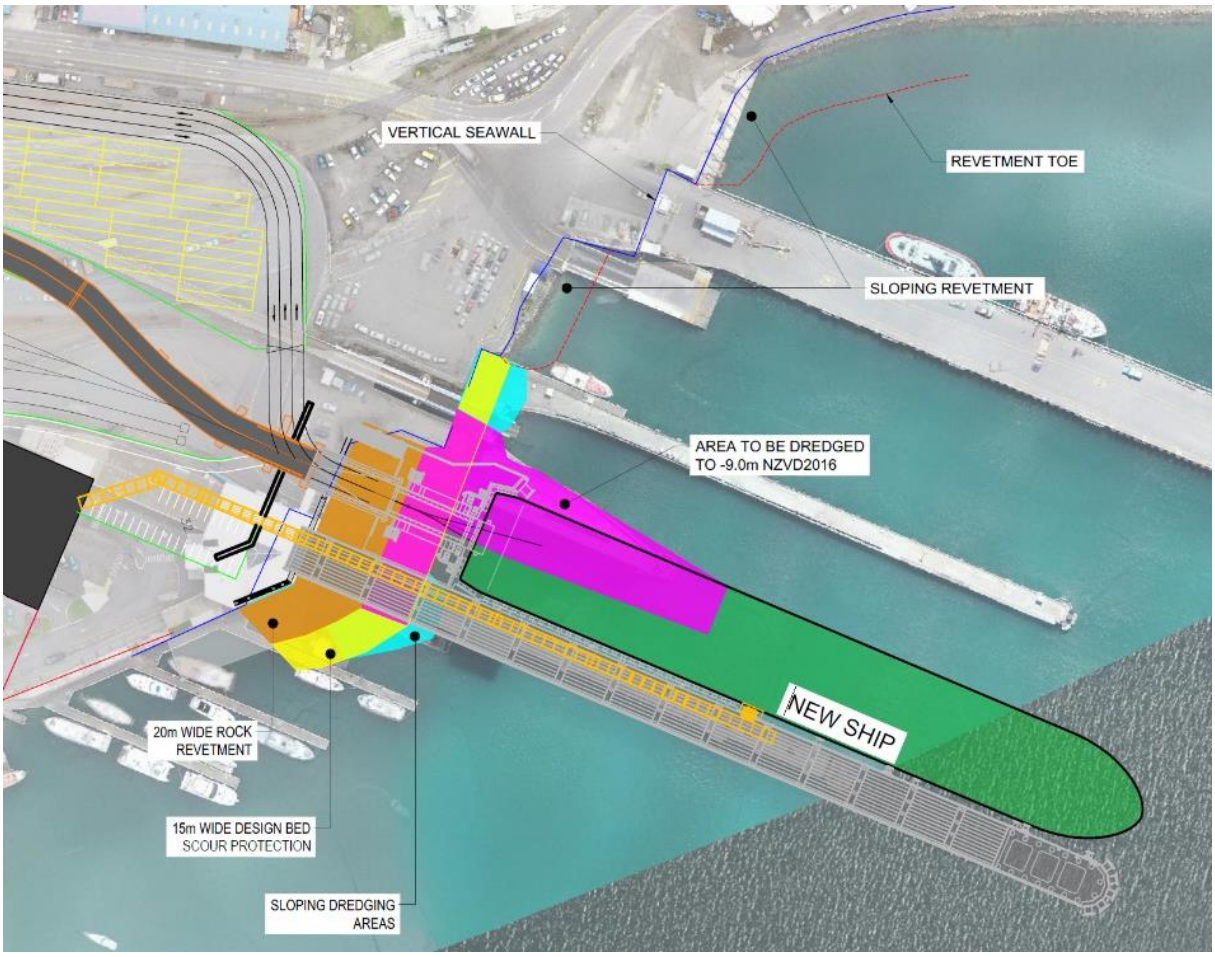
Seawalls, revetments, and scour protection are proposed to provide protection for the new infrastructure and improve port resilience.

The project scope will not include modifications to the existing commercial jetties to the southeast of the ferry terminal building. PMNZ may need to redevelop this area to accommodate larger cruise ships at the eastern berth in the future. The existing pickup/drop-off jetty, demolished with the wharf, will be replaced in the commercial jetty basin to ensure an ongoing connection for ferry and cruise passengers to the water taxis and boat tours. A wide footpath will border the seaward edge of the terminal area to the site's southern boundary.

Twelve swings moorings are being surrendered and removed to prevent conflict with construction vessels and use of the eastern berth to enable the construction works.

The following figure provides an overview of the marine works, including wharf, dredging, seawalls, scour protection, and linkspan structure:

Figure 2: Overview of Marine Works



3.4 Ferry Terminal Building and Carpark

The new terminal building will comprise primarily two levels and will have a building footprint of approximately 2,000m^2. Passenger arrivals and departures will access the elevated passenger walkway to the ships from the terminal level using travellators, lifts, or stairs via a third level of the terminal building. The main entrance and ticketing area, ancillary offices and facilities, and a departure lounge will be provided. Appropriate facilities will be provided for mobility-impaired passengers to move people along the elevated passenger walkway. The new terminal building and elevated passenger walkway are depicted in the figure below.

Figure 3: Conceptual Ferry Terminal Building

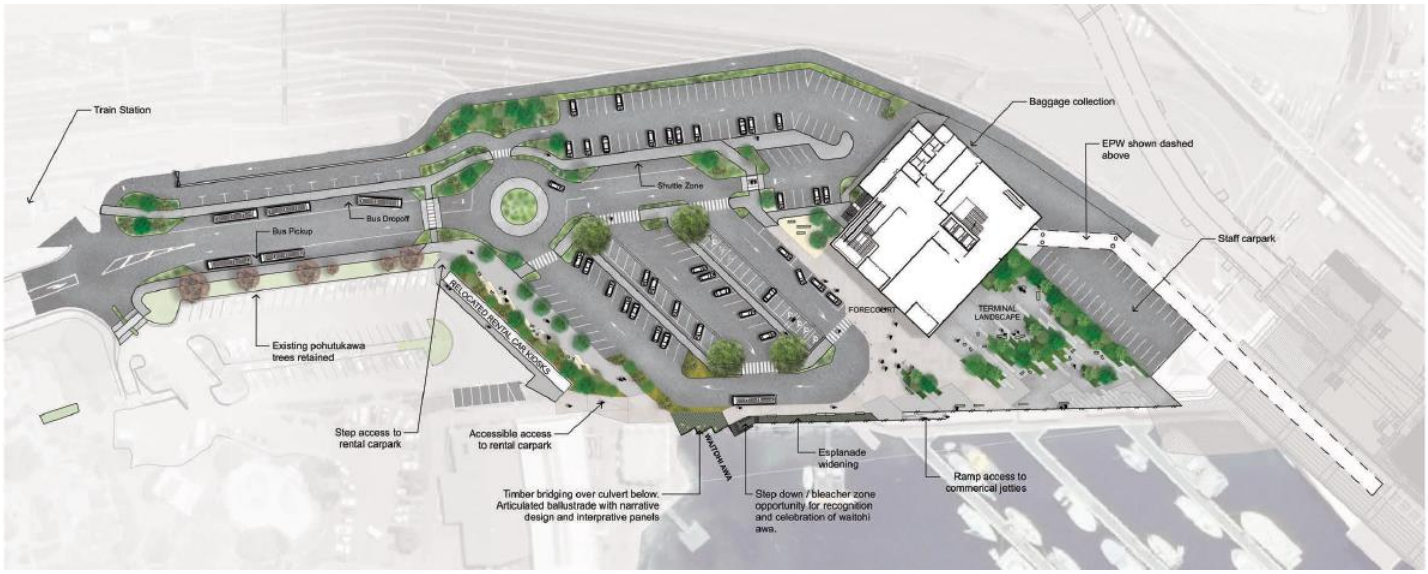
The new terminal building facility and landscaping will support KiwiRail and PMNZ's focus on sustainability for the precinct redevelopment. Sustainability objectives for the project will be measured against the Infrastructure Sustainability Council of Australia (ISCA) criteria.

During the construction period, temporary terminal facilities will be provided, along with temporary elevated walkway access to the ferries to provide safe and efficient passenger services. The temporary facilities may continue to use the existing baggage claim hall.

The proposed landscaping will provide for the terminal's day-to-day operational stormwater management requirements. It will also offer a series of well-connected outdoor spaces that will encourage occupation and express the cultural and natural heritage that underpins this historically important site, including recognition of the outlet of Waitohi Awa.

Reconfigured access, car parking, and bus parking areas will be provided, along with improved landscaping, stormwater treatment and connections with the town centre and foreshore. The new layout will improve pedestrian safety and encourage the use of the waterfront promenade connection into Picton. The concept layout includes increasing the total number of carparks from current numbers and satisfies the requirements for rental cars, long-term parking, shuttles, buses, staff, and berth holders. Relocation of the rental car kiosks to the lower carpark is also included with wayfinding signage for passengers.

Figure 4: Carpark and Landscaping Layout



3.5 Marshalling Yard

The scope includes improving the layout and use of space in the marshalling yard area to cater to the increase in vehicle traffic and improve the efficiency of the rail services. Replacement of the KiwiRail mechanical depot and turntable at the east side of the rail yard allows more space for the marshalling yard and terminal building carpark areas. Limiting the length of the arriving and departing trains to 20 wagons (40 wagon trains will be assembled/disassembled at Spring Creek) has also reduced the rail length to the north into the port operational area.

The proposed works include:

- Relocation of the existing passenger vehicle marshalling yard within the rail yard and new roading and vehicle circulation areas will be established, connecting to Lagoon Road (which is the access used in previous years).
- The marshalling yard track alignments will be adjusted to suit the requirements for manoeuvring and storage of freight.

- The rail turntable and mechanical depot will be rebuilt at the eastern part of the site.
- Construction of a linkspan access overbridge to allow vehicle access from the ferries to the marshalling areas.
- The road freight vehicle marshalling and check-in facilities will continue to be accessed from Lagoon Road, with a new layout, check-in kiosks, and customer amenity facilities. A second exit for freight traffic to the north of the revamped existing entrance/exit for passenger vehicles is proposed to improve the flow of the freight traffic through the marshalling yard.
- New buildings within the marshalling yard will include:
  - Commercial Vehicles Drivers' Amenity and Welfare Building;
  - Private Vehicles Drivers' Amenity and Welfare Building;
  - Motorcycle Shelter Building;
  - Staff Welfare Building;
  - Four Check-in kiosks;
  - Gatehouse (Secure access shelter);
- Landscaping, stormwater rain gardens, and lighting poles are provided.

3.6 Picton Road Network

Several mitigations have been identified to improve the transportation network that arises from the project, including:

- The installation of an overbridge over the railway line and Waitohi Awa at Dublin Street. KiwiRail has committed to this being completed before overall completion of the project irrespective of Waka Kotahi funding;
- Creating a cul-de-sac at Market Street, at the intersection of Dublin Street, where the approach to the Dublin Street bridge is located. A pedestrian link will be established beneath the overbridge to connect Market Street to the Waitohi Reserve;
- Creating a cul-de-sac on Broadway, at the intersection with Wairau Road, for level crossing safety improvements. Pedestrian and cycle connections through to Wairau Road will be retained. There will be an upgrade to the signals, barriers, pedestrian/cycle crossing at Wairau Road/Broadway.

A passenger vehicle outlet to Auckland Street will enable Interislander to meet the 60 minute turnaround times for the peak-peak season non-rail sailings when the ships are full of passenger vehicles. On up to 4 days per year, 150 to 200 passenger vehicles will be released from the rail deck of the ships through the east marshalling yard and onto Auckland Street. Temporary traffic management will be installed on Auckland Street to reduce the potential traffic impacts, particularly at the Auckland/Dublin street intersection. This solution has been extensively tested through traffic modelling to ensure that the port and wider Picton traffic system function effectively.

3.7 Temporary Works and Construction Impacts

To facilitate the various stages of construction, some temporary works will be required, and there will be some impacts on other port users, ferry passengers, and the community. However, the following mitigations will be in place through the construction:

- The installation of the Dublin Street overbridge will require a medium-term closure of Dublin Street to vehicle and pedestrian traffic. The community will be well-informed in advance, and maintenance access to the wastewater pumping station will be available throughout construction.
- Construction will increase traffic on the local roads through town. However, the contractor will establish a site entrance at the Waitohi Domain with temporary bridges over Kent Stream to access the site. Construction traffic on Auckland Street will be infrequent.
- Construction will generate noise from piling and other operations. The contractor will plan their construction methodology to ensure Resource Consent conditions are met. This will minimise the noise impacts on the community and will monitor marine mammal activities in the harbour.
- A temporary terminal building will be required while the new terminal building is constructed. The temporary terminal building location and layout will allow for reasonable vehicle access for passengers, shuttles, buses, and rental car operations to continue safely.

3.8 Design Process

PMNZ has been involved in the design process throughout the project and has ensured that the design aligns with Resource Consent requirements, the Port Master Plan, and community and iwi expectations.

41 South has provided Project Management resources specifically to PMNZ. These and PMNZ internal costs have been paid or agreed to be capitalised in the asset base.

The design process has involved a range of engineering, architectural, planning, and project management consultants. All estimates are built up by quantity surveyors and have been peer-reviewed.

The $358.5M estimate includes a P95 contingency meaning the quantity surveyor analysis indicates a 95% chance the estimate will not be exceeded. P95 contingency amounts to $80M for the project. Additional to this contingency is an 8% escalation ($14.3M) allowance. Other project-related costs for professional fees and contractor costs are further $90.9M across the project. All of these costs are pro-rated across all assets.

PMNZ and KiwiRail are now proceeding with detailed design. The brief to the designers are encapsulated in a Principal's Minimum Requirements (MRs) document. The MRs are detailed specifications defining the minimum owners' requirements for the design as it progresses.

The detailed design is planned to progress in late 2021 based on the agreed concept design. As the design progresses, it will continue to meet the agreed objectives and concept design.

3.9 Conclusion

In approaching the design of the Waitohi-Picton redevelopment, PMNZ's objectives have been to:

- Protect PMNZ reputation and relationships by ensuring that:
  - PMNZ other customers are not disadvantaged
  - Stakeholder commitments are upheld
  - Commitments to Te Ātiawa and the community are upheld
- Safety within our operations is maintained or improved
- Sustainability outcomes are preserved
- Port master plan outcomes are preserved

- Whole-of-life design principles are applied
- The solution fits within the intent of the Resource Consent

The Waitohi-Picton portion of the iReX project has been thoroughly investigated. The concept design meets PMNZ's objectives as well as KiwiRail's operational and affordability requirements. The concept design is agreed upon and thoroughly documented to ensure that PMNZ's objectives continue to be met through the design and construction of the project.

4. COMMERCIAL CASE

4.1 Risk-Based Approach

Since Project iReX is a project of national significance, PMNZ recognised that the approach to commercial negotiations had to reflect the following key considerations:

- In the negotiations, PMNZ did not have a credible threat of being able to walk away from the project
- Given political interest at the central government level and the fact that the budget underwrites new ferries and the associated infrastructure, PMNZ had to be seen to be reasonable both in the positions it took and in how it conducted the negotiations.

PMNZ took a risk-based approach to the negotiation. PMNZ negotiation objectives have been to manage its commercial and financial exposure to balance counterparty risk and PMNZ debt exposure while securing adequate return.

Given the framework created by the Commerce Commission's building blocks methodology, the approach to negotiations was two-fold:

- Minimise PMNZ risk exposure
- Secure a good return / WACC

This approach covers the period during construction (via a Comprehensive Redevelopment Agreement or CRA) and the term of the agreement following the completion of works (via a Lease and Licence Agreement).

Note 1: financial and commercial advice was provided to PMNZ management throughout the negotiation by Alex Sundakov, Executive Director of Castalia.

Note 2: legal and contractual advice was provided by David Chisnall (Partner) and the team from Bell Gully.

4.2 Minimise Risk Exposure

Counterparty Risk

Exposure to counterparty risk was, perhaps, the single biggest consideration in the negotiations. PMNZ carefully assessed counterparty risk and used this risk exposure to leverage other areas in the negotiations.

On balance, though, there are several reasons to see KiwiRail as being a reasonably creditworthy counterparty:

- The investment involved in the procurement of new ferries and the development of new terminal facilities in Wellington and Waitohi-Picton is being substantially covered by Government equity injections into KiwiRail. While the Government may not earn a return on that equity, as a stand-alone commercial entity KiwiRail is likely to remain in the positive cash flow territory.
- Future operation of rail ferries is not guaranteed on a purely market basis. For example, vehicle RO-RO ferries may outcompete KiwiRail for freight. Hence, the future of rail ferries depends not only on the initial Crown investment but on ongoing support from the Crown. However, given the Government's interest in protecting the already committed investment in KiwiRail and the strategic nature of the ferry operations, it is likely that future Governments would provide some support.

- Further, the Government is transferring the annual cost of maintaining the national rail assets owned by KiwiRail to the National Land Transport Fund. This will, in effect, provide a recurrent annual subsidy to KiwiRail and improve its cash flow.

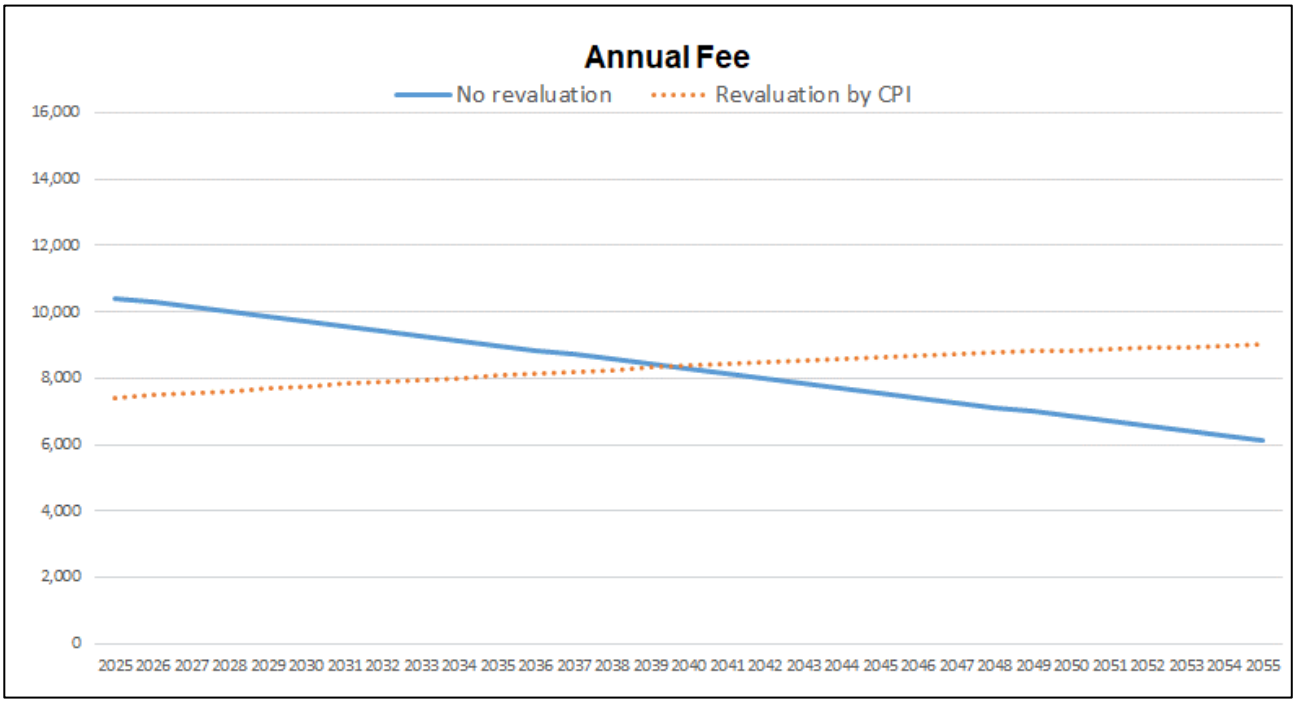
However, risks remain, and PMNZ, with support from MDC, attempted to secure a Crown Guarantee for the contract. The Government rejected the Crown Guarantee because it is already committed to supporting KiwiRail.

In the absence of a Crown Guarantee, PMNZ management sought to manage counterparty risks through five mechanisms:

- Require KiwiRail to provide security in the form of an irrevocable letter of credit covering six months' worth of fee and ground rental
- Require KiwiRail to furnish a parent company guarantee (while this does not protect from KiwiRail bankruptcy, it will ensure that PMNZ has a claim on all KiwiRail cash flows and assets in the event of non-performance).
- Set the depreciation profile such that the return of capital occurs earlier in the life of the project. The Commerce Commission's building blocks methodology envisages two approaches to the depreciation profile.
  - One approach involves straight-line depreciation of the nominal asset base. This means that the amount of depreciation is constant every year in nominal terms, but due to the effects of inflation, more of the capital is returned early in the life of the contract in real terms.
  - The other approach is to revalue the asset every year but to treat revaluation as income. On this basis, the annual depreciation allowance is kept constant in real terms, meaning that the return of capital is stretched out evenly over the contract's life.

  PMNZ has opted for nominal straight-line depreciation. This approach reduces counterparty risk by ensuring that greater capital recovery occurs during the period while the current Government commitment remains life and before technological shocks introduce potential new risks. Graph 1 below shows the annual fee with and without revaluation.
- Ensuring that the total amount of investment was consistent with an annual fee deemed to be affordable and sustainable for KiwiRail. Restricting the amount of funding provided by PMNZ to the project such that the resulting annual fee could be covered from the Interislander cash flows without imposing additional strain on KiwiRail. Our analysis of publicly available information on KiwiRail costs and revenues suggests that the Interislander is likely able to sustain a fee of around $10 million per annum given its current business trends.
- Ensuring that WACC is being paid in cash during the construction period on amounts drawn down from PMNZ funding rather than capitalised in the asset base.

Graph 1: Projected Annual Fee with and without Asset Revaluation



Level of Investment (Gateway 2 – Asset Allocation)

Another way to manage counterparty risk is to manage the exposure to the risk in investment dollar terms. In other words, the lower the investment, the lower the exposure to the consequences of the risk. The question of what the total level of investment should be was pivotal to the commercial negotiations – particularly in a context where:

- Project costs were significantly higher than initially anticipated, with both parties being financially constrained
- KiwiRail was looking for PMNZ to finance as many "port" assets as possible
- PMNZ has several projects in its sights that provide diversification and good commercial returns
- PMNZ's ability to contribute to the project relied on debt funding through its shareholders' facility
- No Government guarantee was available for future security against the project

In that context, an offer of $100m (+/- 10%) was determined to be the ideal level of investment, subject to securing the right quality and type of assets.

To secure the right quality and type of assets, PMNZ established a 'hierarchy' of assets as an order of preference for ownership subject to price. This was as follows:

1. Port strategic assets – 'wet assets' such as the wharf, dredging, and marine infrastructure.
2. Improvements on PMNZ land – land-side improvement to car parking seawalls etc.
3. The ferry terminal building

PMNZ also determined it would not finance specialised assets such as link spans as funding non-specialised assets reduced the risk of asset stranding in the future. The agreed cost breakdown and allocation are depicted in Table 1. These numbers include contingency, escalation, design, and contractor costs.

Table 1: Asset Allocation

	KiwiRail Assets	PMNZ for KiwiRail
Terminal Building	$42.5	
Ancillary Buildings	$6.2	
Temporary T. Building	$5.0	
Civil Works	$47.5	$15.6
Rail Works	$37.8	
Marine Works	$1.3	$13.0
Wharf and furnishings	$4.0	$56.7
Walkway and gangway		$17.3
Primary Link-span	$75.2	
Transition Link-span	$9.3	
Utilities	$10.1	$5.3
Demolition	$11.6	
Total	**$250.6**	**$107.9**

As shown, through negotiation, PMNZ was able to secure its preferred hierarchy of assets, noting the following:

- **Ferry Terminal –** the ferry terminal building, is unaffordable within the investment envelope. However, owning the ferry terminal provides no additional benefit to PMNZ for the following reasons:
  - PMNZ has secured the aesthetic and sustainability features of the new ferry terminal through the Minimum Viable Product documentation.
  - PMNZ has negotiated a reinstatement clause whereby PMNZ may at its option take ownership of the relevant KiwiRail improvement and asset with no cost or compensation payable by PMNZ to KiwiRail at the end of the lease/or default—effectively giving PMNZ ownership of the building at that point.
  - There are no additional commercial benefits in owning the building under the input methodology as any ancillary income would be deductible from the model
- **Cruise Berth -** A key feature of the Asset Allocation agreement is that PMNZ has secured the ability to develop the eastern side of the new wharf for a cruise even though KiwiRail will pay for the entire cost of constructing the wharf through the annual fee. PMNZ will be required to spend approximately $12-$18 million to develop a 250m to 300m cruise berth. The quantum of additional cost will depend on the vessel size PMNZ will seek to accommodate. These costs are not included in the asset base costs above and this development will be subject to a separate business case. The wharf may require

additional strength to accommodate future cruise ships. This will be confirmed during the concept design verification stage of the project. If required, the strengthening is estimated to add $2 to $5 million to the base wharf build cost. This cost would be met by Port Marlborough. The decision to strengthen the wharf will be required early in the detailed design process.

- **Demolition –** Through negotiation PMNZ ensured that all demolition costs are directly funded by KiwiRail – current estimate is approximately $10M.

Minimise Risk During Construction - Comprehensive Redevelopment Agreement (CRA)

De-risking measures adopted and agreed in the CRA Key Terms include:

- PMNZ has agreed to a fixed price delivery arrangement with KiwiRail of $108 million. Under this arrangement, the total maximum amount of funding to be provided by PMNZ is fixed, with KiwiRail taking on the responsibility for delivery and accepting all cost overrun and programme risks.
- The risks around health and safety, quality control and reputation during the construction have been addressed through PMNZ's involvement throughout the project in a governance role, with all costs incurred by PMNZ to be paid by KiwiRail - the delivery method is discussed later in this business case.
- The current fee paid by KiwiRail will continue during construction until completion and will have CPI applied annually.
- The future fee payable by KiwiRail under the Building Block Method will be based on $108 million (plus agreed management costs incurred by PMNZ) as opposed to the true and final development costs.
- WACC is paid during the construction period on amounts drawn down from PMNZ funding rather than capitalised in the asset-based
- PMNZ is, therefore, fully insulated from delivery risks and can secure a known return to the shareholder.

Notwithstanding the above, PMNZ has agreed that if final construction costs for PMNZ assets are less than $108 million, then KiwiRail can pay back up to 10% of those savings to PMNZ. This is entirely consistent with the NPV=0 concept.

Minimise Risk During Lease and Licence

De-risking measures adopted and agreed in the Lease and Licence Key Terms include:

- As part of the Lease and Licence Agreement, PMNZ has negotiated that the annual fee payable by KiwiRail is not dependent on the volume of KiwiRail's business. It is a fixed facility fee payable as long as the facilities are available:
  - If the facilities are out of operation due to KiwiRail fault (for example, due to the ferry damaging the berth), KiwiRail is obligated to continue to pay the fee
  - If the facilities are out of operation due to PMNZ default (lack of adequate maintenance), the fee will be decreased in proportion to the impact
  - If the facilities are out of operation due to Force Majeure, KiwiRail is obligated to pay PMNZ the cost of debt calculated using the cost of debt in the WACC formula (which is higher than the actual cost of MDC debt). It is worth noting that the definition of Force Majeure has been significantly tightened compared to the current Lease and Licence. At present, a Force Majeure is called if KiwiRail is not

able to operate its services. For example, this may include an earthquake in Wellington, which leaves Picton unaffected. Under the new agreement, Force Majeure would only relate to specific physical unavailability in Picton.

- All OPEX costs are a pass-through to KiwiRail. PMNZ is protected from any operational risks, which will lead to increased operating costs in the future. OPEX charges include a full pass-through of all insurance costs, largely insulating PMNZ from major physical risks. The new Lease and Licence also ensures any new future operational costs incurred by PMNZ related to KiwiRail's operation can be passed on – a significant improvement on the current contract.
- The agreement requires the development of a five-year Asset Management Plan to be jointly agreed upon by PMNZ and KiwiRail to ensure that repair, maintenance, and replacement is consistent with best engineering standards. The cost of implementing the plan is passed through to KiwiRail. This de-risks PMNZ and ensures that asset lives and asset conditions are optimised.
- PMNZ is substantially protected from the asset stranding risk. The contract is for 30+30 years, with all investment fully depreciated (that is, all capital returned) over that period. If KiwiRail decides not to renew the contract after the first 30-year period, it is obligated to pay PMNZ a termination balloon payment equal to 39 percent of the remaining asset value in the asset base. To illustrate, if the asset base is $108 million, with capital returned on a straight-line basis, the remaining value at the end of year 30 will be $54 million. If KiwiRail chooses not to renew the contract, it will be obligated to pay $54*0.39 = $21 million as the termination payment. PMNZ will have to be left with a well-maintained 30-year-old wharf and other marine facilities with an unrecovered nominal value of $33 million in 2055 dollars to use as it sees fit. KiwiRail will also be obligated to pay for make-good on any KiwiRail assets located on PMNZ land. The 39% figure for the balloon payment was calculated based on the analysis of strandability. Strandability is the proportion of the asset, specific to KiwiRail's needs and will not have additional market value if KiwiRail stops using it, and what costs would be incurred by PMNZ (including opportunity costs) if KiwiRail does not renew the contract.

4.3 Weighted Average Cost of Capital

With the risk allocation and other commercial elements agreed, the key commercial issue focused on determining the appropriate WACC.

Since the Commerce Commission does not produce specific input methodologies for ports, PMNZ considered that it could interpret the Settlement Agreement requirement for the fee to be "based on" the Commerce Commission building blocks model in three ways:

- A strict application of a single internally coherent Commerce Commission Input Methodology for a sector that it does regulate. This would require us to choose which of the electricity, airports, and gas industries is closest to the project's risk profile and choose one of those methodologies to be applied in a fully consistent manner.
- Pick-and-choose approach. Construct WACC out of the parameters selected by the Commerce Commission for its input methodologies, but choose each parameter from any of the three methodologies based on being most representative of the Project iReX risk profile.
- Derive loose guidance from the Commerce Commission – While still being guided by the Commerce Commission's Input Methodologies, depart from its approach on specific parameters where such departures are justified.

There is no single sectoral input methodology that is ideal for PMNZ. None of the sectors regulated by the Commerce Commission share the risk profile of PMNZ's investment in Project iReX. While the airports may appear to be the closest comparator, the risks are different.

- The airports' input methodology has the most attractive asset beta (0.6) of all other sectors, but it assumes A- debt credit rating, which leads to a lower cost of debt than other methodologies. Moreover, the Commerce Commission applies the midpoint of the WACC estimates to airports, while it allows the 67th percentile of the estimates to be used for other sectors. This creates a disadvantage of about 50 basis points for airports. Together, the low cost of debt and the choice of the percentile largely offset the benefit of relying on the airports' Input Methodology compared to the strict application of other sectoral Input Methodologies.
- It is also difficult to counteract KiwiRail's argument that airports face much greater volume risk than PMNZ under the fixed fee. Hence, if PMNZ used the airports' input methodology, it faced the risk of conceding on the beta while being faced with other unfavourable features of that Methodology.

For this reason, from the start, PMNZ approached the negotiation with the view that in the absence of specific port input methodology, the term "based on" should be interpreted as "broadly applying the same principles" as the Commerce Commission.

In practice, this meant both picking and choosing among the existing Input Methodologies and departing from them as appropriate. This approach was assisted by KiwiRail submitting an initial low ball WACC offer in which it departed from the Commerce Commission's Input Methodologies to calculate a WACC using the lowest possible value for each parameter.

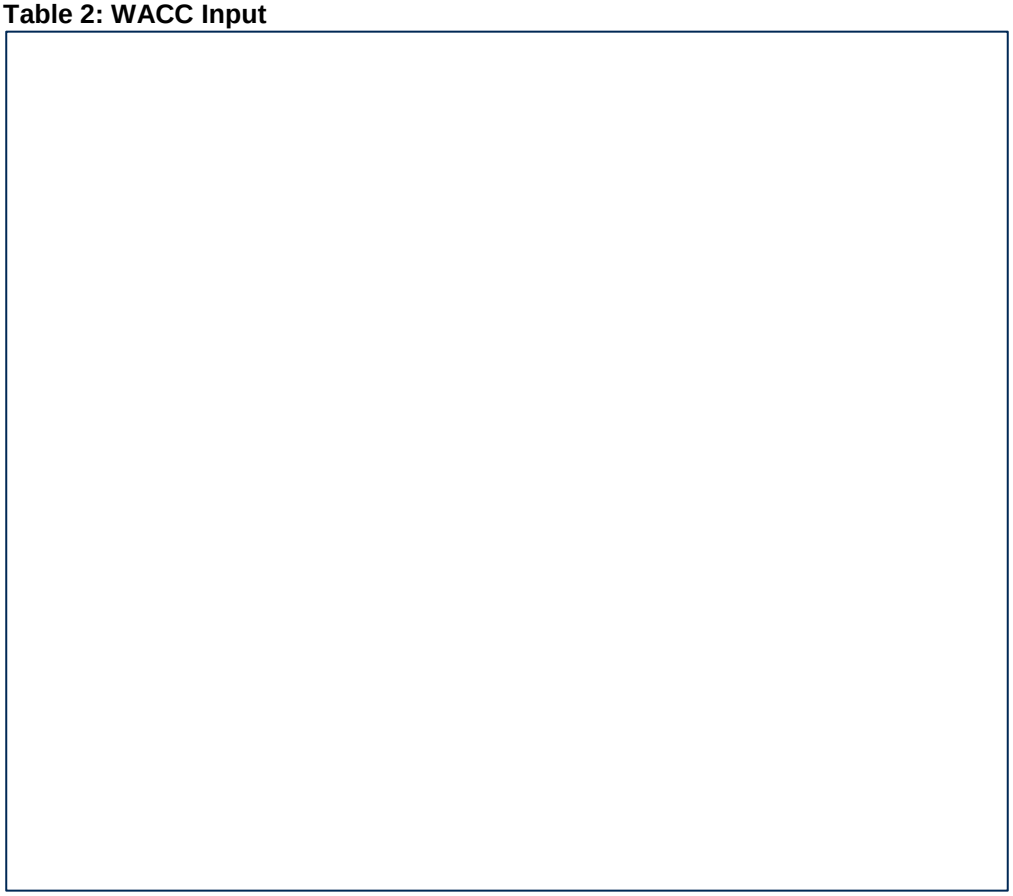
Overall, PMNZ was able to achieve a reasonable WACC outcome given the need to remain within the principles of the Commerce Commission's approach and the substantial de-risking achieved:

- PMNZ and KiwiRail agreed on a compromise asset beta of ..... (existing WACC in the contract was based on an asset beta of 0.51)
- The risk-free rate will be based on the 10-year government bond. This compares to the 5-year bond (5 years yield to maturity) used by the Commerce Commission. Since the yields on longer-term bonds are higher, this represents an advantage of approximately 20 basis points
- The debt credit rating will be BBB+ with a 40% leverage
- Both parties agreed to adopt the market risk premium of 7% used by the Commerce Commission.

The table below shows the WACC estimated using the above parameters, the current risk-free rate, and the debt risk premium.

The actual risk-free rate and the debt risk premium will be set using the average for the 30 days before the commencement of the CRA and then reset every two years on the anniversary of the commencement (with a separate reset on the commencement of the Lease and License).

Table 2: WACC Input



4.4 Conclusion

This commercial deal provides an opportunity to anchor KiwiRail in the region with a 60-year Contract. While the investment is significant:

- Returns achieved are good
- Financial exposure is capped
- Counterparty risks and asset stranding risks have been significantly mitigated throughout all aspects of the negotiated Key Terms of this contract.

Detail of the Key Terms as agreed with KiwiRail are included in Appendix 1. KiwiRail Board has approved those terms. A detailed analysis of risks and associated mitigation measures are included in Appendix 2.

5. FINANCIAL CASE

5.1 Annual Fee

The annual payments to be made by KiwiRail will consist of:

- The annual Building Block Methodology fee consists of the depreciation allowance, WACC on the opening asset base, and tax provision.
- Annual OPEX and R&M costs pass-through
- Ground rental calculated on the PMNZ land area occupied by the assets owned by KiwiRail or being used by PMNZ assets provided for KiwiRail
- A figure to account for tax adjustments

5.2 Building Block Model fee (BBM)

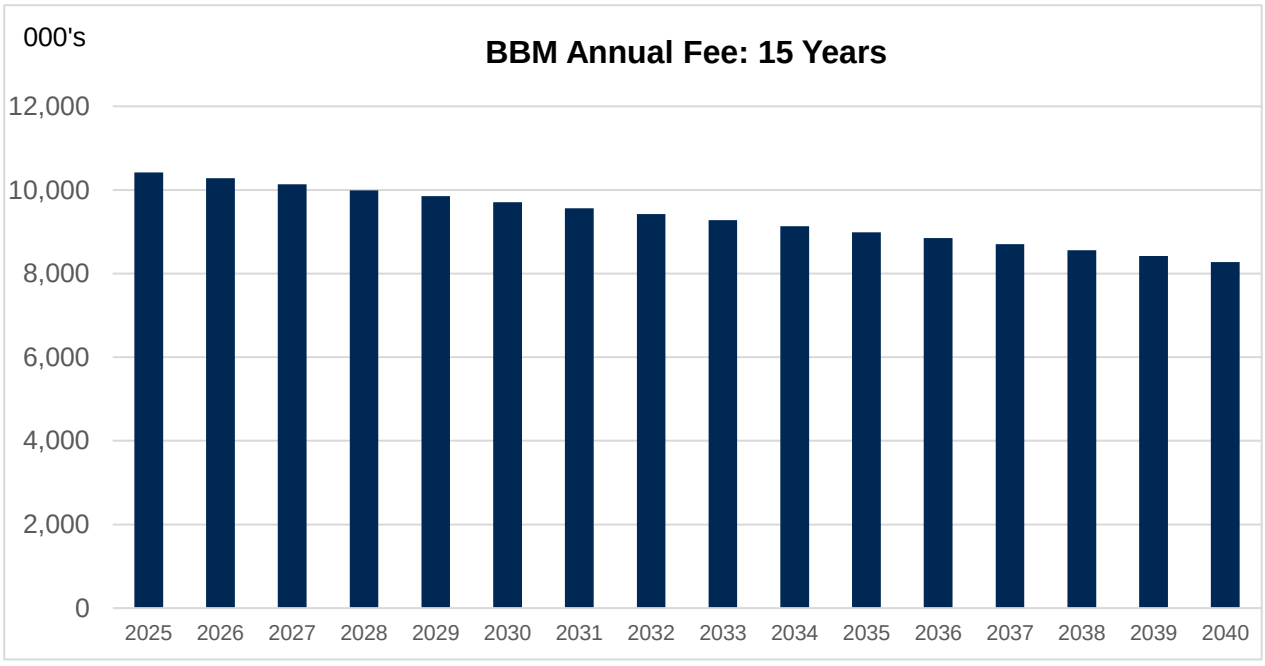
The agreement reached with KiwiRail is that the annual fee (excluding ground rental) will be based on an opening asset base of $108 million as agreed with KiwiRail plus PMNZ project management costs during construction. Noting that any additional project costs will come out of PMNZ cash-flow and, while they will be put into the model for fee calculation, will not require debt funding.

Graph 2 below shows the composition of the BBM fee and its level over the first 15 years of the contract, calculated using the current WACC.

The actual risk-free rate and the debt risk premium will be set using the average for the 30 days before the commencement of the CRA and then reset every two years on the anniversary of the commencement (with a separate reset on the commencement of the Lease and License).

Consequently, the fee will vary depending on future changes to the risk-free rate and the debt risk premium. Since the interest rates are likely to increase, the actual fee over the next ten years will likely be somewhat higher than modelled.

Graph 2: Projected BBM Annual Fee



5.3 Operational Expenses

In addition to the part of the fee relating to the return on and of capital (WACC and the depreciation allowance), KiwiRail will be responsible for the following operating expenses:

- Rates, electricity, and water for exclusive use areas to be paid directly by KiwiRail where practical (metering systems to be installed as part of the PMNZ works where possible);
- Insurance cost associated with damage to the Premises and Business Insurance cover;
- Port Security and Harbour Radio costs, to be allocated evenly across the commercial wharves (PMNZ will bill a standard monthly fee with year-end wash-up);
- Navigational Aids and Harbour Levy, to be allocated based on the number of vessel visits over 500GT PMNZ will bill a standard monthly fee with a year-end wash-up;
- PMNZ Overheads will be allocated over the cost centre based on revenue
- Any land or similar tax concerning the Premises or compulsory charges payable by PMNZ that may arise during the term
- Costs for repairs and maintenance (proactive and reactive)
- Any future operational costs that relate to the KiwiRail operation

Currently, costs of overheads, Port security, and Navigational Aids attributable to Interislander total $1.3M per annum. These are included in the fixed fee under the Settlement Agreement along with insurance costs, rates, and repairs and maintenance

5.4 Ground Rental

The level of the ground rental has not yet been fully agreed, although KiwiRail has agreed with the following concepts:

- Ground rental is applied to leased areas at 100% of the rate
- Ground rental is applied to licenced areas on a percentage of utilisation basis
- Ground rental shall be subject to appropriate and reasonable valuation benchmarks and methodologies. For example, it is agreed that there needs to be an appropriate market comparator outside Picton with some downward adjustment factor to reflect Picton conditions (nominally accepted as Wellington port industrial land) with a deeper market for industrial type land. This will be finally agreed upon as part of the CRA negotiations. However, independent valuers retained by PMNZ suggest that Picton ground rental could be set at 50% of the Wellington land rental values, which would currently result in $37 per sqm. The current rental market in Picton is at $25 per sqm.
- The Ground Rental will be reviewed every five years based on the Wellington market outcome and the same discount factor for Picton.

5.5 PMNZ 10 Year Capex Programme

The proposed project will require a significant increase in PMNZ borrowing. It is important to ensure that the resulting capital structure is efficient and sustainable in light of the overall PMNZ business portfolio. The equity

ratio (equity divided by equity plus debt) represents a useful measure of leverage and risk posed by such leverage.

An equity ratio of 1 means that there is no debt. Such a ratio is inefficiently conservative. In line with the Statement of Corporate Intent, PMNZ considers the equity ratio of 0.5 to 0.7 appropriate for its business: ratios above increase the cost of capital relative to the benchmark, while ratios below progressively increase liquidity risk.

PMNZ has updated the ten-year model regarding the latest commercial negotiations and upcoming capital expenditure programme outcomes. It assumed:

- A capital expenditure program as scheduled in Table 3 below
- Loan interest rates for the iReX are projected at 3.3% (based on ten-year rates as per LGFA)

Table 3: Schedule of Capital Expenditures (10-year plan)

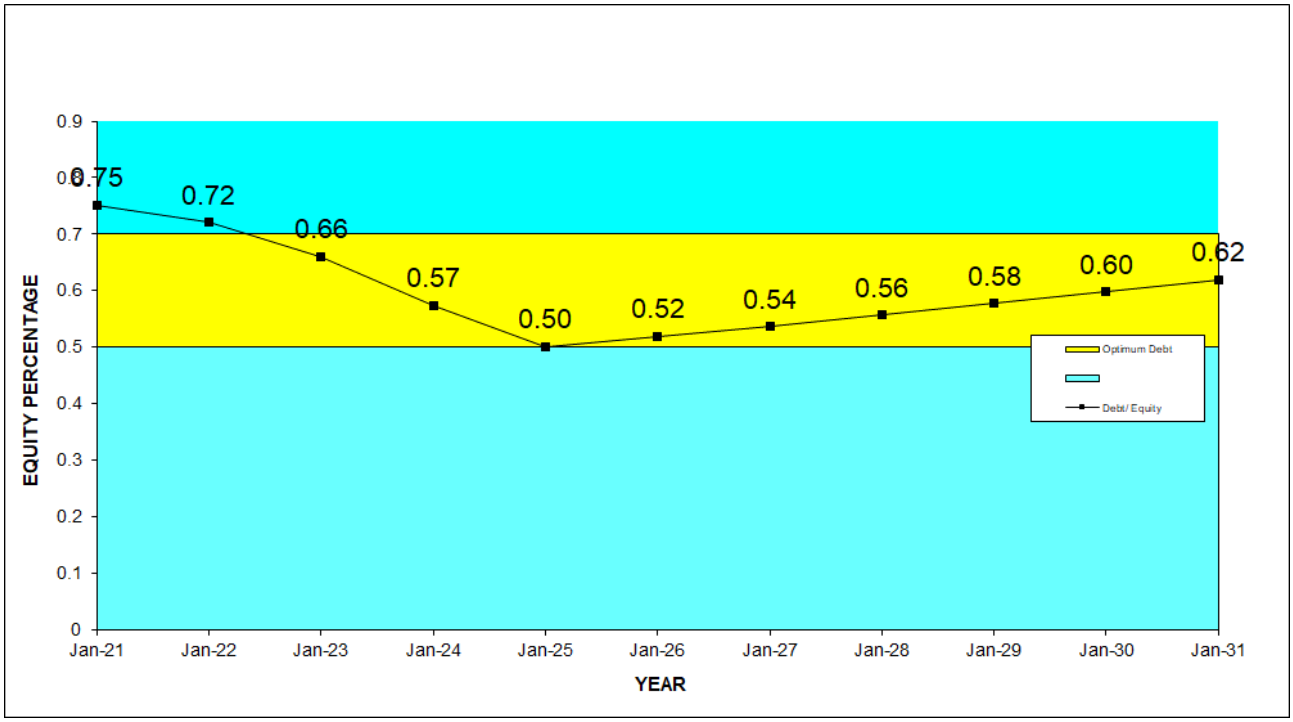
	FY22[1]	FY23[2]	FY24[3]	FY25[3]	FY26	FY27	FY28	FY29	FY30
Capex	$25.5	$33.3	$54.9	$63.4	$5.4	$5.4	$5.4	$5.4	$5.4

Note:

- [1] includes Waikawa Marina Extension (WME)
- [2] includes end of WME, a new tug, upgraded Havelock wooden jetties, and a $6 million lump-sum contribution to the upgrade of Waitohi Stream culvert
- [3] includes iReX capital disbursements essentially occurring in FY2024 and 2025. Since PMNZ negotiated for KiwiRail to pay WACC during construction, KiwiRail is likely to draw government funds in the first instance.
- $5 million capital development after that

PMNZ currently has low debt and is starting with a conservative equity ratio. Graph 3 below shows equity ratio projections with the proposed funding for the project. It indicates that during the construction phase and early operation phase of the project, which coincides with other investments being undertaken by PMNZ, the equity ratio will be on the edge of our recommended equity ratio.

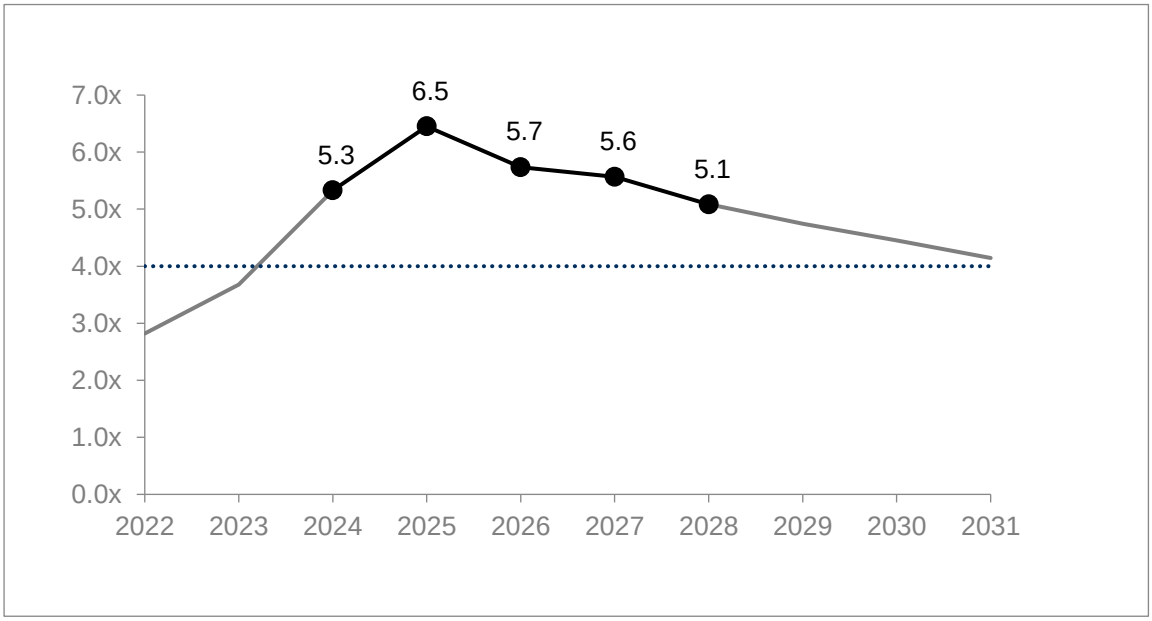
Graph 3: Projected Equity Ratio



PMNZ is currently experiencing high demand for capital with several projects in the pipeline. The modelling shows that with an investment level of $100M (+/-10%) plus a $6M contribution to the Waitohi culvert, PMNZ is still able to pursue other opportunities of the scale of around $5M per annum without compromising the equity ratio. However, the 10 year model does not include provision for major redevelopment projects such as the cruise berth.

PMNZ also reviewed the expected debt to EBITDA ratio (Graph 4) and interest coverage ratio (Graph 5).

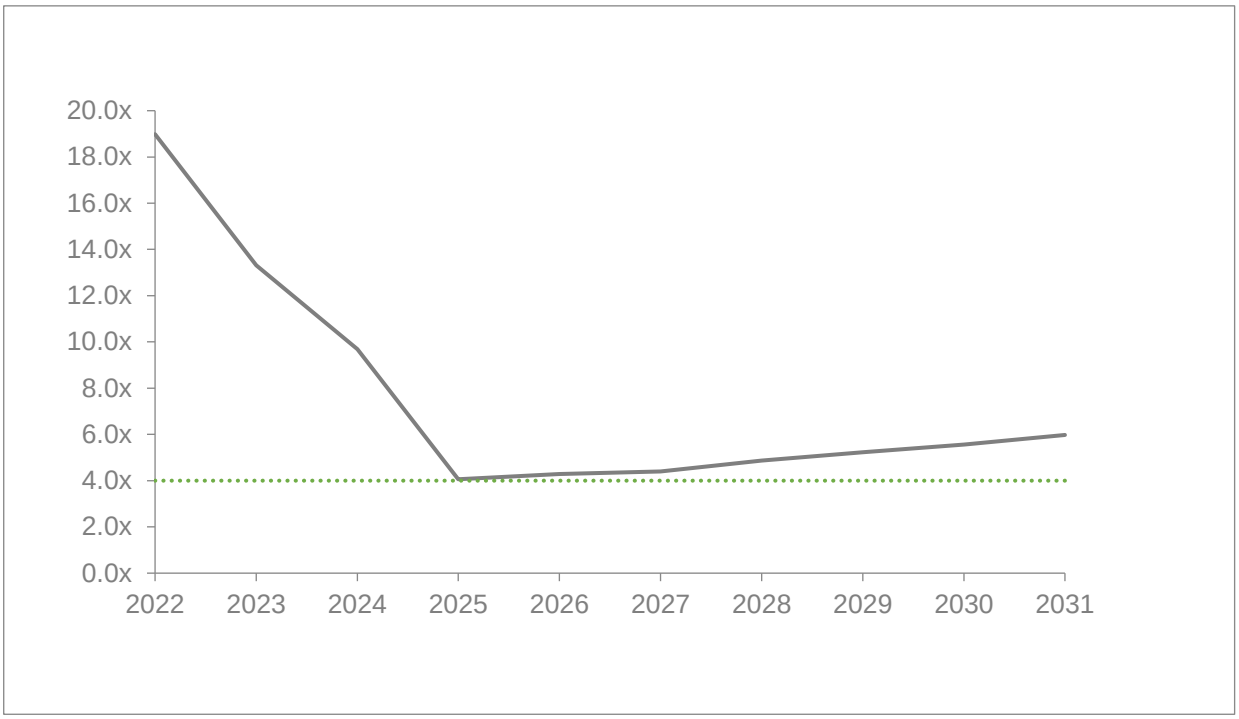
Graph 4: Debt to EBITDA ratio



Graph 4 is based on the assumption that PMNZ investment in Project iRex is debt financed. In general, debt/EBITDA ratios at 4 times are considered reasonable, while ratios above 5 times may signal elevated liquidity risk. However, the ratio needs to be interpreted within the specific context of iRex project:

- Additional project revenue is largely de-risked and is not subject to fluctuations based on demand or price
- Higher than usual debt to EBITDA ratios have become more acceptable due to low interest rates
- The project financial structure provides for a relatively rapid return of capital and ensures that the ratio begins to decline immediately after peaking in the final year of construction, and returns to target levels over period of around 5 years.

Graph 5: Interest Coverage Ratio



Graph 5 shows that PMNZ's ability to repay interest remains reasonably comfortable despite the temporary peak in the debt to EBITDA ratio.

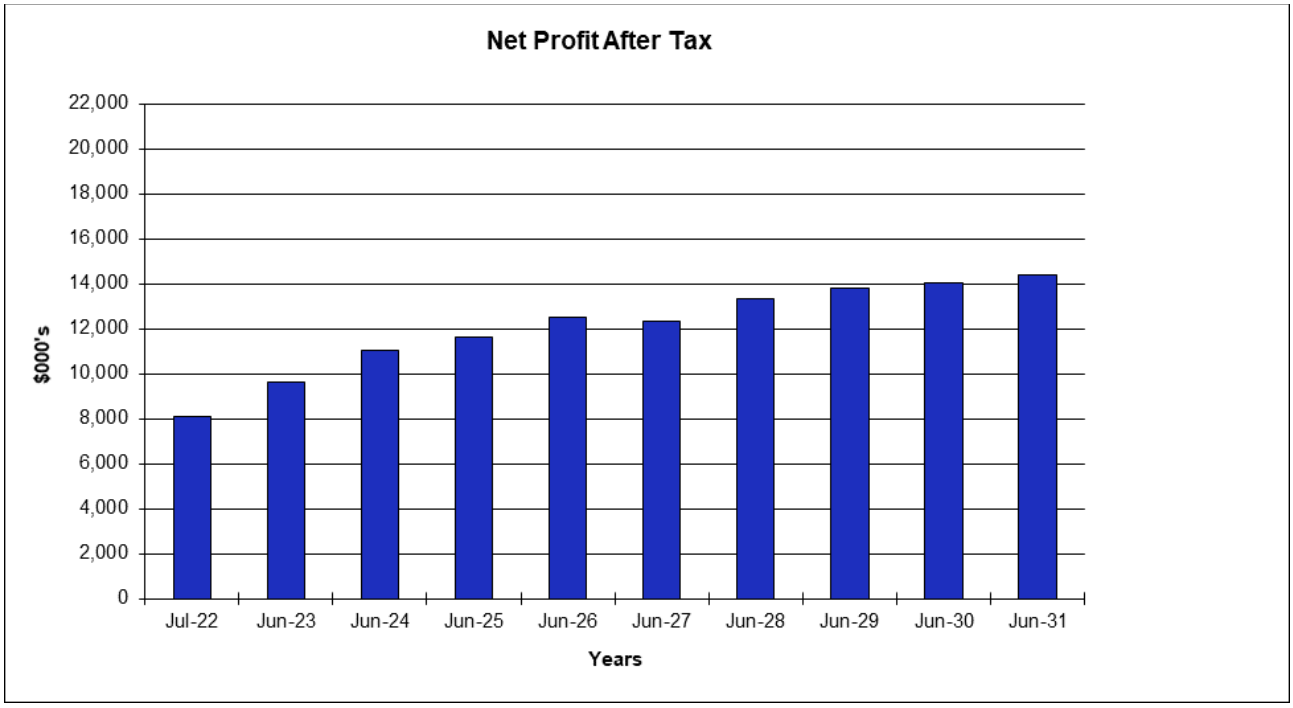
In general, banks become concerned about a company's ability to service debt if the interest coverage ratio falls below 1.5.

In fact, PMNZ interest coverage ratio never falls below 4, and recovers to be above 6 within 5 years. Again, given the underlying stability of revenues from KiwiRail, this ratio indicates high degree of financial stability being enjoyed by PMNZ even with the additional debt.

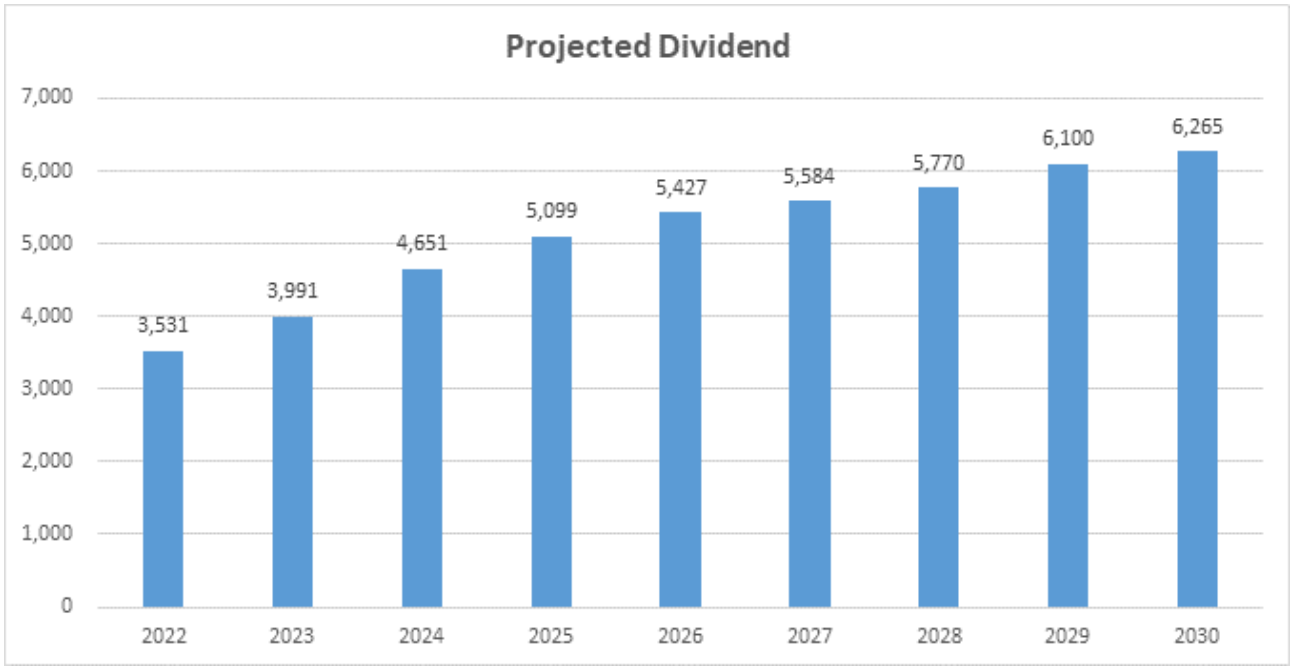
PMNZ intends to repay the project loan and drawdown new loans to fund new developments, with each project evaluated on its own merit.

Under this model, the projected net profit after tax progressively increases (Graph 6), and under the existing dividend policy, the shareholder receives a growing and substantially higher dividend return (Graph 7).

Graph 6: Projected Net Profit After Tax



Graph 7: Projected Dividend



5.6 Comparison of Annual Fee and Dividend – Existing vs. Proposed

It is useful to consider how PMNZ profits and dividends will change as a result of the project. Under the Settlement Agreement, KiwiRail contributes approximately $2.66 million per year to PMNZ's operating profit. Assuming a 28% tax rate and 45% dividend rate, KiwiRail currently contributes approximately $0.86 million per year to PMNZ's dividend to MDC.

Table 4 below shows that under the current dividend policy, KiwiRail's contribution to PMNZ's dividend will increase to $1.73 million per annum upon lease and licence commencements, after considering the additional debt service cost and depreciation.

Table 4: Annual Fee and Dividend Comparison Pre and Post iReX

	Existing Fee	**New Fee Yr 1**
WACC	Beta: 0.51	Beta: .....
Annual Fee	$5.16M	$10.42M
Land Rental	Included est. $0.35M	Plus est. $0.35M
Opex	Included $0.80M	On top of fee
Insurance	Included $0.30M	On top of fee
Overheads	Included $0.70M	On top of fee
R&M	Included $0.50M	On top of fee
End of life	2025	2085
Tax depreciation	**$0.20M**	**$1.8M**
Interest 3.3%		**$3.63M**
Operating Profit	**$2.66M**	**$5.34M**
Operating Profit after tax	**$1.91M**	**$3.84M**
Dividends[1]	**$0.86M**	**$1.73M**

It is worth noting that the overall revenue from the project (comprising the fee, the OPEX provision, and the Ground Rent) will, from the commencement of the new lease and licence replace the current all-up revenue of $5.16 million received annually from KiwiRail. At first glance, PMNZ proposes spending $110 million to increase its pre-tax revenue from $5.16 million (growing by inflation) to around $10.77 million (reducing over time).

However, since PMNZ is currently generating that $5.16 million a year from largely depreciated infrastructure serving vessels that KiwiRail considers obsolete, it makes the existing revenue not sustainable by itself. PMNZ is currently enjoying the last few years of being able to sweat old assets. The proposed investment is necessary and unavoidable to retain KiwiRail as a customer. Doing nothing would result in losing the business.

5.7 Debt Exposure at the end of the term

PMNZ is looking to fully debt fund this project through the Council via the Local Government Funding Association.

From the modelling undertaken, PMNZ can use its retained cash from the project (which comprises retained post-tax profit and the depreciation allowance) to repay its debt and ensure minimal exposure at the end of the first 30-year contract term in 2055.

If PMNZ uses all of its retained cash generated by project iReX to repay the iReX debt, it would be fully repaid at the end of 2055. Dividends would be slightly higher in subsequent years as the cost of debt service would reduce more quickly.

If PMNZ uses 84% of its retained cash generated by project iReX project to repay its debt, the debt at the end of the first term will be equivalent to the KiwiRail balloon payment of $21 million. This is the amount that would be due to PMNZ if KiwiRail does not review the contract.

Either option shows that PMNZ debt exposure at the end of the first term is low – albeit the project is 100% debt-financed.

PMNZ prefers the former option of repaying 100% of the debt with the cash generated by the project. This leaves the ability to re-draw money if required to finance other capital projects.

5.8 WACC Mismatch

PMNZ anticipates that there could be a possible mismatch between the WACC calculated for the Building Blocks Model and the actual cost of debt.

Under the agreed WACC calculation methodology, WACC will be reset every two years to update the variable components: the risk-free rate and the debt risk premium.

By contrast, PMNZ/MDC borrowing could fix the actual cost of debt for the tenure of the debt. This could create both upside and downside risks for PMNZ:

- If the debt interest rate is fixed over the period during which interest rates are increasing, PMNZ would be a net winner: periodic reviews of WACC would result in it increasing, and the benchmark cost of debt included in the WACC calculation will continue to exceed the actual cost of debt
- On the other hand, if the debt interest rate is fixed over a period during which interest rates are decreasing, PMNZ would lose. Periodic WACC reviews would result in declining WACC, and hence the possibility that the benchmark cost of debt included in the WACC calculation may fall below the actual cost of debt.

Over the next ten years or so, interest rates are likely to keep rising. At present, the benchmark cost of debt is approximately 40 basis points higher than the actual cost of 10-year LGFA debt, and this positive gap is likely to grow. However, over the entire term of 30 years, there will be periods when the opposite will be true.

PMNZ/MDC may need to manage its liabilities actively to address this risk. One possibility could be to refinance MDC debt at every WACC reset. Whether this is practicable will depend on MDC's flexibility and the transaction costs of each refinancing. If it is too costly to align debt tenure and WACC review periods, it may still be possible to minimise the risk through periodic re-financings that reduce the gap without eliminating it. PMNZ will need to work with MDC to coordinate efficient liability management.

5.9 Funding

PMNZ is looking to fully debt fund this project through the Council via the Local Government Funding Association. This enables PMNZ to borrow at a lower finance rate than what would be achieved through mainstream banking avenues. However, to proceed with this and owing to the scale of investment, PMNZ requires two sets of approvals:

1. Shareholder's approval will be independently required as the project is close to the threshold of the Major Transaction test as per Company Act 1993. A major transaction under clause 129 (2a) is defined as the acquisition of, or an agreement to acquire, whether contingent or not, assets the value of which is more than half the value of the company's assets before the acquisition; or

   PMNZ's total assets are anticipated to be close to 205 million by June 2021, which is at the cusp of the Major transaction requirements. PMNZ anticipates low risk as it has regularly communicated with MDC Holdings and the Council on the project and quantum of investment.

2. A public consultation process is required to raise debt through MDC. This process has been catered for through the gateway established in the P3DA and communicated to KiwiRail. Arrangements are currently in progress

If the funding is not available by the Council as a result of the consultation, there are two potential consequences:

- PMNZ would need to look at other bases of funding, but this is not the preferred option. The likelihood would be that PMNZ borrows at a higher rate, reducing the dividend going forward. Banks may require several covenants that may reduce PMNZ operations. External borrowing would continue to affect Council Credit rating as the debt will be reflected in the consolidated financial statement.
- The project does not proceed as planned, and the deal would need to be re-negotiated. Government interventions and political pressures would be high risk - particularly in a context where ferries have already been ordered and the programme is tight. Any government interventions could result in KiwiRail funding Port's strategic assets. PMNZ would be giving away significant business revenue streams, and subsequent dividend returns to its shareholders

5.10 Conclusion

The fee under the existing contract is not sustainable vessels are ordered, and infrastructure needs to change. Furthermore, it is inflexible by not allowing pass-through of increasing or new operational expenses.

The new fee provides a better return (higher asset beta) and substantially reduces the risk exposure compared to the existing contract.

Funding for the project requires shareholder approval as a major transaction and MDC approval for using the LGFA facility (via a public consultation). Alternative funding would be problematic.

However, subject to securing funding, the proposed investment fits within PMNZ's equity ratio envelope and will provide long-term, sustainable, and growing dividend returns to the shareholders.

6. MANAGEMENT CASE

6.1 Delivery Method

PMNZ has agreed to a fixed price delivery arrangement with KiwiRail in the Comprehensive Redevelopment Agreement (CRA). Under this arrangement, KiwiRail takes on responsibility for delivery and accepts all cost and programme risks. The risks around quality control and reputation during the design and construction are addressed through PMNZ's involvement in a project governance role.

Development of the design is being delivered under a single contract for both the Wellington and Picton terminals. The single design consortium across both terminals is intended to provide cost and programme efficiency in sharing design elements between the sites where appropriate. KiwiRail is engaging the designers with PMNZ and CentrePort having governance roles to ensure that all asset owner objectives are met through the design. Tenders are currently being evaluated for the design package, with the contract award anticipated for December 2021.

Design is programmed to take nine months, by which time long lead materials will be ordered and enabling construction works underway. Contractor procurement envisages an Early Contractor Involvement (ECI) model, where the selected designer will be novated to a contracting consortium. The ECI delivery will ensure that contractor knowledge is incorporated into the design to optimise project delivery. Picton and Wellington will likely be delivered under separate construction contracts.

6.2 Delivery governance

With the delivery model having KiwiRail owning all cost and programme risks, the risks around quality control and reputation during the construction are addressed through PMNZ's involvement throughout the project in a governance role.

The CRA key terms provide a set of agreed 'best for project' principles intended to inform governance decision-making throughout the project's life, including specific acknowledgment of the MVP and required community and environmental outcomes. Any variations to the MVP need to be agreed upon by PMNZ and KiwiRail with any additional costs for variations to be met by the party seeking the variation.

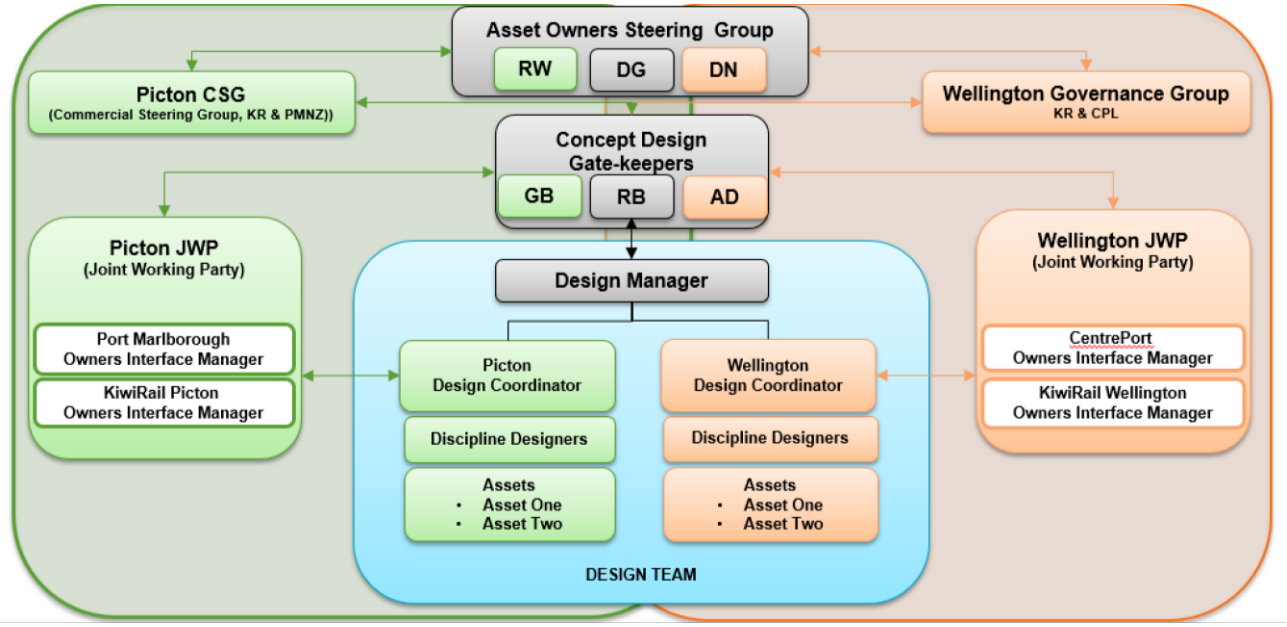
6.3 Design

Joint governance and delivery model has been agreed for delivery of the design under the P3DA. The delivery model for the design is a partnership approach, where PMNZ, CentrePort, and KiwiRail will provide a technical owner-designer interface for the assets they will own. KiwiRail will be the Principal engaging the consultants to deliver the design, with formal instructions, directions, and approvals given by KiwiRail to the designer.

To ensure efficient design development that meets our requirements, PMNZ will have ongoing input to the design process and contact with the design team. Through the design process, PMNZ will have involvement in:

- design meetings with the design team;
- decision making input relating to sustainability and whole of life costs;
- communications with iwi, community, and stakeholders as part of the communications on the project.

An overview of the delivery structure and key relationships is provided below.



This design delivery model has several key features

- Dedicated technical discipline teams for Picton and Wellington to focus on specific issues at each location, combined with an over-arching design management function to standardise the design approach between the terminals where appropriate.
- Joint Working Party (JWP) with Owner Interface Managers from each Asset Owner's organisation. The JWP will work at the project management level to ensure the design meets the requirements of the agreed concept design.
- Concept Design Gatekeepers (CDG) will provide project governance oversight to guide the design process to achieve "best for project" outcomes and provide an escalation point for the JWP.
- Commercial Steering Group (CSG) will agree to any changes to the Minimum Viable Product (MVP), ensure engagement with and communication to the public, iwi, and other stakeholders occurs as required, and provide an escalation point for the CDGs
- Asset Owners Group will provide overall design programme governance to resolve any issues escalated unable to be resolved at the CSG level
- Gate Review Process - Each design phase will be reviewed and approved by the CDGs at each design gate, separately for each terminal. The CDG will assess whether the services meet the agreed objectives and requirements of the design. The agreed design gates reviews are:
  - Gate A – Concept (25%) design verification
  - Gate B – Preliminary (50%) design
  - Gate C – Developed (75%) design
  - Gate D – Detailed (100%) design
  - Gate E – Issued for construction

Construction work will not be permitted to commence without appropriate design gate approvals.

6.4 Construction

The detail of the governance structure for construction has yet to be finalised. The agreed principles for the governance of construction delivery are closely aligned with those for the design. These principles will provide PMNZ with a forum for input and approvals as asset owners, port operators, and resource consent holders. Input and approvals will be via KiwiRail to the contractor(s). The principles include working together to manage interfaces between the construction works and the port's operations through appropriate site management protocols.

6.5 PMNZ resourcing

The delivery structure agreed with KiwiRail will require significant PMNZ resources to ensure the successful delivery of the project. The resource will focus predominantly on ensuring that quality outcomes are achieved for the project and that PMNZ's project objectives are achieved.

A base loading of 2 FTEs will be required until the completion of the project. This will consist of a full-time project manager, supported primarily by project engineering, communications, and project governance support. At its peak, we anticipate up to 5 FTEs for short durations, particularly around design gate reviews, contractor engagement, and contractor start-up. These additional resources will be a combination of internal and external resources and have been agreed to be capitalised – the quantum to be agreed in the CRA.

Roles that have been identified for the PMNZ delivery team include:

- Project Governance – project delivery, commercial and KiwiRail relationship
- Project Management
- Design
- Construction supervision and oversight
- Asset Management
- Environmental
- Sustainability
- Resource Consent
- Health and safety – in design and through construction
- Landside Operations
- Marine Operations
- Communications – Iwi and Community Engagement
- Design forum
- Administrative support
- Peer Reviewers- Wharf, seawalls, ground improvements and scour protection particularly

CRA key terms agree to PMNZ's ongoing involvement in the delivery of the project with details to be agreed in finalising the CRA.

6.6 Programme

The project programme is highly focused on the delivery of the first new ship in September 2025. This date was locked in when KiwiRail placed the order for the new ships in June 2021. This forces a very tight timeframe for delivering the project. The programme contingency has eroded through the design sprint, and commercial negotiations and currently sits at only three months. This is extremely optimistic in the currently constrained design, construction, and supply chain markets. Feedback on even the design programme is that there is no room for variations, rework, or delays in the design. This highlights the importance of the programme risk resting with KiwiRail. A high-level programme is provided in Appendix 3, with key milestones being:

- P3DA
  - 14 March 2022 Gateway 4 (funding confirmed)
  - 29 March 2022: Sign CRA
- Delivery
  - December 2021 – September 2022: Detailed Design (start and finish at risk)
  - February 2022: Order long lead materials
  - March 2022: Commence enabling works
  - October 2022 – August 2025: Terminal Building construction
  - November 2022 – August 2024: Sea walls construction
  - August 2023 – August 2025: Wharf construction
  - November 2023 – May 2025: Linkspan construction

6.7 Next Steps

Under the Phase 3 Development Agreement, upon approval of the Key Terms by the Board, Gateway 3 will be completed, and PMNZ will proceed to funding (gateway 4).

Subject to MDCH approval, the proposal will then proceed to the Marlborough District Council for funding via a public consultation process – estimated to take around three months.

Upon approval of funding and reception of tender document, the Comprehensive Redevelopment Agreement will be completed for final PMNZ Board approval.

6.8 Conclusion

KiwiRail will take on responsibility for delivery and accept all cost and programme risks.

Quality control and reputation during the design and construction delivery are addressed through PMNZ's governance role in the project.

PMNZ will require an ongoing resource to continue to provide input, review, and monitor quality during the delivery of the project. These costs will be capitalised to form part of the asset base, the quantum to be agreed in the CRA.

The project programme is very tight to meet ship delivery in September 2025.

7. OVERALL CONCLUSIONS AND RECOMMENDATIONS

PMNZ plays a vital link in New Zealand's supply chain by providing infrastructure for Cook Strait ferries.

KiwiRail is PMNZ's largest customer, and the Interislander ferry service substantially contributes to the region's prosperity. KiwiRail has replaced its aging Interislander fleet with two new rail-enabled vessels that require upgrades to the infrastructure at both sides of the Strait.

The Waitohi-Picton portion of the iReX project has been thoroughly investigated. The concept design meets PMNZ's objectives as well as KiwiRail's operational and affordability requirements. The concept design is agreed upon and thoroughly documented to ensure that PMNZ's objectives continue to be met through the design and construction of the project.

KiwiRail will take on responsibility for delivery and accept all cost and programme risks. At an already agreed $108M capital expenditures, PMNZ is guaranteed a range of assets (including strategic port assets) and an agreed return on and of capital. This approach fully insulates PMNZ from construction and programme risks.

Quality control and reputation during the design and construction are addressed through a clear project governance structure. PMNZ Project Management costs incurred during construction will also be capitalised on top of the already agreed $108M.

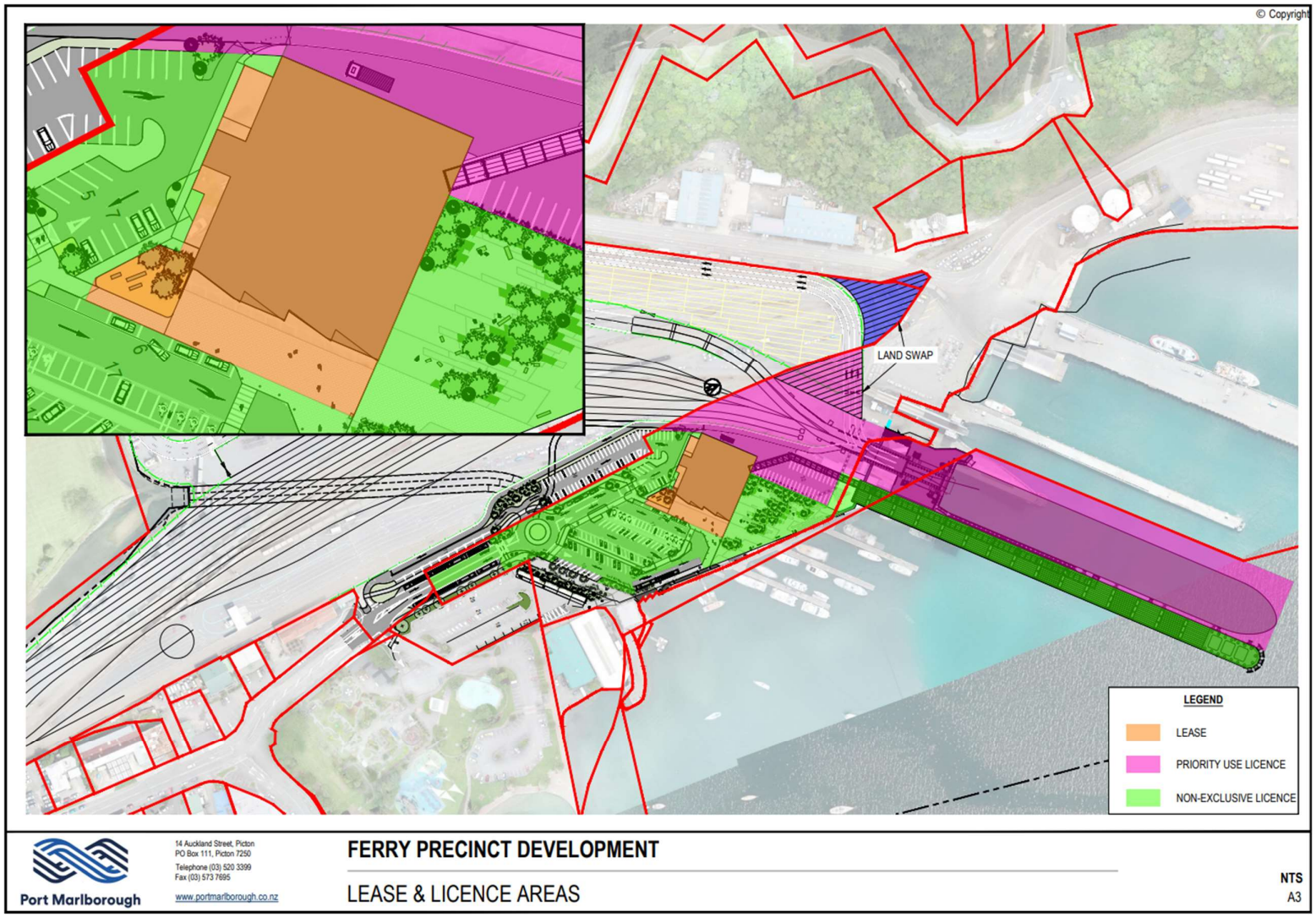
It is important to note that the existing fee generated by KiwiRail continues until the completion of the project but is not sustainable longer-term. The existing infrastructure is aging, new vessels have been ordered, infrastructure needs to change, and the importance of the route nationally means this is a must-do project.

The proposed investment will provide long-term, sustainable, and growing dividend returns to the shareholders.

We **recommend** Marlborough District Council Holdings:

- Approve the proposed major transaction and capital investment of $110 million to acquire new ferry precinct assets
- Seek to secure debt funding for the project via its sole shareholder Marlborough District Council (MDC).

APPENDIX 1 – KIWIRAIL LAND AND PMNZ LAND MAPS



APPENDIX 2 – ASSET ALLOCATION

Picton Development Costs

			Funding/Ownership Allocation %					Funding/Ownership Allocation $				
Asset / Asset Group	**Total**	**Workings (PMNZ part/fully funded assets)**	**KR**	**PMNZ 4 KR**	**PMNZ 4 PMNZ**	**Other**	**Comment**	**KR**	**PMNZ 4 KR**	**PMNZ 4 PMNZ**	**Other**	**Total**
Works to enable wharf sequence TPW	7.3		100%			0%		7.3	0.0	0.0	0.0	**7.3**
Utilities	7.3	$ 7,275,463.76	64%	36%		0%	Utilities cost apportioned based on % of work on PMNZ/MDC land	4.6	2.6	0.0	0.0	**7.3**
Demolition	5.9		100%			0%		5.9	0.0	0.0	0.0	**5.9**
Civil Works - Ground Improvement (behind seawall)	1.9	$ 1,899,814.26	0%	100%		0%		0.0	1.9	0.0	0.0	**1.9**
Civil Works - Other 5a Marshalling yard works 5b Upper car park 5c Waitohi Reserve	15.7	$ 15,744,600.01	67%	33%		0%	Civil, pavement scope and landscaping works apportioned based on % of work on PMNZ/MDC land	10.5	5.2	0.0	0.0	**15.7**
Civil Works - Structures 6a Upper bridge 6b Waitohi Culvert	8.8		100%			0%		8.8	0.0	0.0	0.0	**8.8**
Civil Works - Dublin St Overbridge (50% of total cost)	4.7		100%			0%		4.7	0.0	0.0	0.0	**4.7**
Marine Works - Seawalls	3.4	$ 3,412,954.26		100%		0%		0.0	3.4	0.0	0.0	**3.4**
Marine Works - Scour Protection / Dredging	3.1	$ 3,105,043.79		100%		0%		0.0	3.1	0.0	0.0	**3.1**
Wharf	30.6	$ 30,571,405.04	7%	93%		0%	Automooring $2m KR cost	2.0	28.5	0.0	0.0	**30.6**
Linkspan Nesting Structure	11.8		100%			0%		11.8	0.0	0.0	0.0	**11.8**
Linkspan	26.4		100%			0%		26.4	0.0	0.0	0.0	**26.4**
Walkway / Gangway	8.7		0%	100%		0%		0.0	8.7	0.0	0.0	**8.7**
Buildings - New Terminal	20.7		100%			0%		20.7	0.0	0.0	0.0	**20.7**
Buildings - Other	3.1		100%			0%		3.1	0.0	0.0	0.0	**3.1**
Rail Works	19.2		100%			0%		19.2	0.0	0.0	0.0	**19.2**
Other	0.5		100%			0%		0.5	0.0	0.0	0.0	**0.5**
Terminal building exterior changes (delta from Gold)	0.85		100%				Refer: Memo - Updated Landscaping and Terminal Prices	0.9	0.0	0.0	0.0	**0.9**
Landscape and car park changes (Delta from Gold)	0.8			100%			Refer: Memo - Updated Landscaping and Terminal Prices	0.0	0.8	0.0	0.0	**0.8**
Replacement Pick up drop off jetty (PUDO)	0.7		100%				Refer: PMNZ - Seawall Extension 20211006 Note: sewall type and extension info provided by PMNZ email 06/10/2021	0.7	0.0	0.0	0.0	**0.7**
Seawall extension	0.8				100%		Refer: PMNZ - Seawall Extension SoP 20211006 Sketch 4 Note: sewall type and extension info provided by PMNZ email 06/10/2021 "Commercial Seawall sketch 061021.pdf"	0.0	0.0	0.8	0.0	**0.8**
Base Build Cost	**$182.4m**		**69.79%**	**29.74%**	**0.46%**	**0%**		**$127.3m**	**$54.2m**	**$0.8m**	**$0.0m**	**$182.4m**
Property Acquisition	1.6		100%			0%		1.1	0.5	0.0	0.0	**1.6**
Professional Services (Design)	20.1		pro rata					14.0	6.0	0.1	0.0	**20.1**
Professional Services (Consenting)	3.6		pro rata					2.5	1.1	0.0	0.0	**3.6**
Construction overheads etc	60.8		pro rata					42.4	18.1	0.3	0.0	**60.8**
Port costs agreed to include in asset base	1.1			100%		0%		0.0	1.1	0.0	0.0	**1.1**
KR Team costs	0.0		100%			0%		0.0	0.0	0.0	0.0	**0.0**
Total, before contingency and escalation	**$269.6m**		**70%**	**30%**	**0%**	**0%**		**$187.4m**	**$81.0m**	**$1.2m**	**$0.0m**	**$269.6m**
Escalation	13.7		pro rata					9.6	4.1	0.1	0.0	**13.7**
Contingency	76.8		pro rata					53.6	22.9	0.4	0.0	**76.8**
Total project	**$360.2m**		**70%**	**30%**	**0%**	**0%**		**$250.6m**	**$107.9m**	**$1.7m**	**$0.0m**	**$360.2m**
Total escalation and Contingency	$90.5m							$63.2m	$26.9m	$0.4m	$0.0m	**$90.5m**

APPENDIX 3 – PRICING MODEL

-

Input Data

Macro Economic

Parameters

Inflation	%	
Contract Life	years	60
Tax	%	28.0%

WACC

General Inputs

Debt ratio	%	40.0%
Risk free rate	%	.....

Cost of Debt

Debt risk premium	%	.....
Debt issuance costs	%	.....
Cost of debt - pre tax	%	**.....**

Cost of Equity

Asset beta	#	.....
Equity beta	#	.....
Market risk premium	%	7.0%
Cost of equity - post tax	%	**.....**

WACC Components

Cost of Equity - Pre Tax	%	.....
Cost of Debt - Pre Tax	%	.....
Cost of Equity - Post Tax	%	.....
Cost of Debt - Post Tax	%	.....
WACC - Pre Tax (Nominal)	%	**.....**
WACC - Post Tax (Nominal)	%	**.....**

Project Inputs

OPEX

Operating costs	NZD 000's/yr	
Overheads	NZD 000's/yr	
Total	NZD 000's/yr	**0**

RAB

Project CAPEX	NZD 000's	100,000
IDC	NZD 000's	
Total	NZD 000's	**100,000**

	Input 1	Input 2	Units	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
Calculations																	
Switches																	
Revalue assets in which years? (1 = On)			*1,0*	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Flags																	
Flags	Start	End															
Construction	2021	2024	*1,0*	1	1	1	1	0	0	0	0	0	0	0	0	0	0
Commercial Operation	2025	2084	*1,0*	0	0	0	0	1	1	1	1	1	1	1	1	1	1
Asset Revaluation			*1,0*	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Building Blocks Model Calculations																	
Regulatory Asset Base																	
Opening RAB			*NZD 000's*	0	0	0	0										
CAPEX			*NZD 000's*	0	0	0	0		0	0	0	0	0	0	0	0	0
Revaluation			*NZD 000's*	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Depreciation			*NZD 000's*	0	0	0	0										
Closing RAB			*NZD 000's*	**0**	**0**	**0**	**0**										
Tax Deductible Expenses																	
Notional Interest		*Tax Dep. Sum*	*NZD 000's*	0	0	0	0										
Tax Depreciation		100,000	*NZD 000's*	0	0	0	0										
Total			*NZD 000's*	**0**	**0**	**0**	**0**										
Outputs																	
Required Revenue Items																	
Return of capital (depreciation)	Nominal WACC - post tax		*NZD 000's*	0	0	0	0										
Return on capital			*NZD 000's*	0	0	0	0										
OPEX			*NZD 000's*	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Revaluation			*NZD 000's*	0	0	0	0	0	0	0	0	0	0	0	0	0	0
Total before tax adjustment			*NZD 000's*	**0**	**0**	**0**	**0**										
Tax Items																	
Gross Tax Adjustment			*NZD 000's*	0	0	0	0										
Tax Shield			*NZD 000's*	0	0	0	0										
Net tax adjustment			*NZD 000's*	**0**	**0**	**0**	**0**										
Total Required Revenue			*NZD 000's*	**0**	**0**	**0**	**0**										
Checks		*PV*															
PV check for Return on and of capital		*100,000*	*NZD 000's*	*0*	*0*	*0*	*0*										

Appendix 2: Risk Register

Waitohi Picton Ferry Precinct Redevelopment Risk Register - Updated 26 October 2021

RISK ASSESSMENT AS AT AUGUST 2020							CONTROLS IN PLACE AS AT OCTOBER 2021	AFTER CONTROLS	
Risk #	**Risk Title**	**Description**	**Cause**	**Result**	**Current Controls**	**Risk**	**Action**	**Residual Risk**	**Further Treatment or Outcomes**
1	Affordability and Funding	CAPEX unaffordable to KR.	**1)** KR CAPEX not sufficient for required infrastructure. **2)** Infrastructure - high design standards required by PMNZ / KR PR's. **3)** High costs associated with new infrastructure requirements and KR business continuity during construction and timeframe.	**EITHER** **1)** Project cannot go ahead as currently considered. Change of scope/quality to match available funding. Pressure from Central govt. or KR to reduce quality. PMNZ and community expectations not met **OR** **2)** Project receives more Central govt. funding **OR** **3)**Programme delays. PMNZ out of pocket for design expenses. Reputational damage.	**1)** P2DA states MVP for project - changes to be made by consensus of commercial steering group. **2)** KR & PMNZ looking at 'value engineering' without compromising quality. **3)** Existing lease / settlement agreement allows PMNZ to withdraw from project.	E	**COMPLETED DESIGN SPRINT –** • Overall Project CAPEX reduction ~$200m • Signed up for new ferries • KiwiRail has confirmed CAPEX affordable	**L**	
2	Affordability and Funding	CAPEX is unaffordable for PMNZ	Designed infrastructure exceeds or is likely to exceed $150m cap.	**1)** PMNZ does not own all infrastructure on its land - i.e. terminal building **2)** PMNZ loses additional benefits or ability to influence outcomes e.g. 5 green star rating or berth 6	Current proposal is a fixed contribution offer by PMNZ for a 'group' of assets irrespective of actual cost in order to meet timeframes of KR. I.e. $140m contribution for terminal building, wharf, services and associated transitional berths. Fee is based on $140m, PMNZ own assets at end of construction irrespective of cost.	E	**AGREED ASSET ALLOCATION AND PRICE $108M -** • PMNZ has reduced it's contribution to max ~$108m. • This will be a **fixed price** for assets on its land excluding terminal building • MVP agree and documented • Terminal building concept agreed – ISCA ratings will be applied • PMNZ will have a governance role in the project ongoing	**L**	Finalise project governance structure
3	Affordability and Funding	PMNZ funding process is unsuccessful due to shareholder dissatisfaction with risk profile	Project not sufficiently de-risked or costs estimates too high. Return too low. MDC-GG and Councillors do not feel sufficiently informed.	Project does not go ahead in current form. Project delayed. Reputational damage	**1)** Risk based approach to negotiation. **2)** KR and Ministers approached for guarantees over project **3)** MDC-GG regular meetings with transparency over project **4)** Direct shareholderfeedback to understand key areas of concern and mitigations **5)** No surprises approach	E	**RISKS ADDRESSED** • Reduced investment profile to reduce exposure to counter party risk. Asset allocation selected least strandable assets plus balloon payment agreed to eliminate standable components of asset base • Securities agreed – parent co guarantee plus bank guarantee • Fixed price agreed • Received ministerial level advice that no govt. guarantee available only assurance that govt. will stand by KR • WACC provides adequate return for risk	**L**	Agree treatment of Waitohi culvert
4	Affordability and Funding	PMNZ funding process is unsuccessful due to community dissatisfaction	Public consultation feedback is negative based on perception of wider project / community interfaces. Public do not feel sufficiently informed. Perceived value to community not realised (no cycle path, no cruise, traffic etc.)	Project does not go ahead in current form. Project delayed. Reputational damage	Addressing wider project benefits through negotiation. Aligning approach with MDC	E	**RISKS ADDRESSED** • Overbridge on Dublin St • New ferries better environmental outcomes • Reduced investment profile to reduce exposure to counter party risk. • Securities agreed – parent co guarantee plus bank guarantee. Fixed price agreed • Received ministerial level advice that no govt. guarantee available only assurance that govt. will stand by KR • WACC provides adequate return for risk	M	Work with MDC on story telling

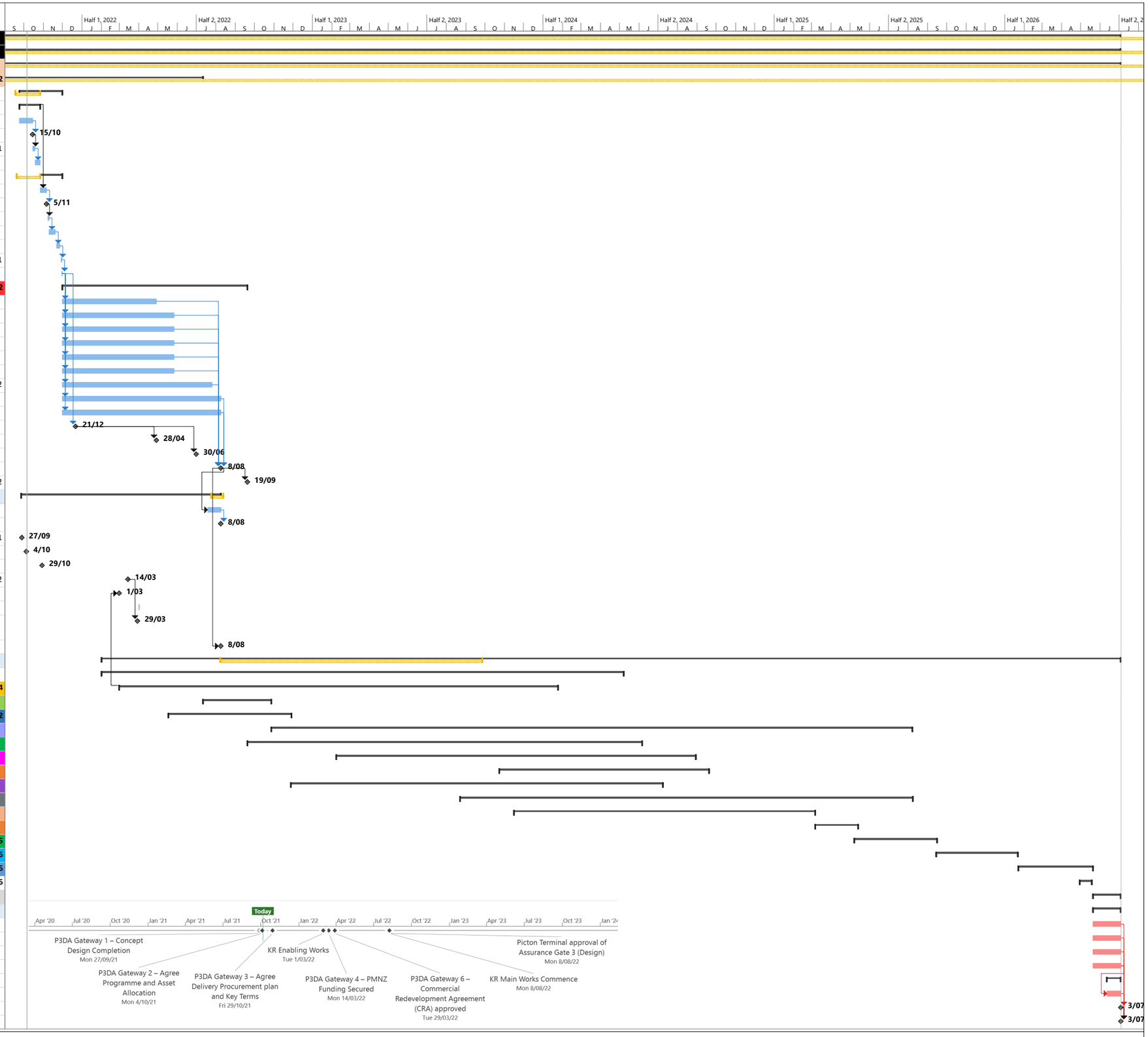
5	Commercial	Opportunity cost	KR do not accept PMNZ's ability to use Berth 6 is compensation for loss of Berth 4	Berth 6 not used for cruise. Community expectations not met, reputational damage. Lost opportunity for Picton Inc.	Current proposal explicitly states berth 6 is compensation for berth 4	E	**AGREED TERMS FOR LEASE** • PMNZ will have the right to use berth 6 in the future for zero $ buy-in	**L**	Ensure detailed design allows for cruise
6	Commercial	Entire project not agreed prior to CRA	Ship process, Wellington terminal etc..not programmed / agreed	PMNZ enter agreement without clarity of overall project	Making any deal unconditional on other parts of project delivery	E	**AGREED TERMS FOR CRA** • KR continues to pay existing fee until practical completion KR takes risk for construction delays and/or cost overrun to completion (subject to no PMNZ interference) plus • WACC on progressive investment by PMNZ • KR pay PMNZ agreed costs if CRA not entered into	**L**	
7	Commercial	SH pressured to accept unattractive terms	Nationally significant project. Central govt. / political pressure applied to MDC to accept unattractive terms. MDC cannot be seen to be party to scupper nationally important project.	Contract is high risk with no protections (no guarantees). Low returns. Not compensated for opportunity costs etc. PMNZ master plan not achieved. Long-term loss of shareholder value.	Initial approaches made to Ministers & Cent. Govt.	H	**RISKS ADDRESSED** • Deal now imminent and provides attractive terms	**L**	
8	Affordability and Funding	Fee is unaffordable for KR based on asset base owned by PMNZ	BBM based on asset base results in a fee that KR business model cannot afford - assumptions rely on unrealistic growth assumptions and/or continued govt. support.	EITHER 1) Project cannot go ahead as currently considered. Change of scope/quality to match available funding. Pressure from Central govt. or KR to reduce quality. OR 2) KR look to grind down fee to a position that does not work for PMNZ	1) P2DA states MVP for project - changes to be made by consensus of commercial steering group. **2)** Risk based approach to negotiation to balance risk reward fairly **3)** Existing lease / settlement agreement allows PMNZ to withdraw from project.	H	**RISKS ADDRESSED** • Reduced investment profile to reduce exposure to counter party risk. • Securities agreed – parent co guarantee plus bank guarantee • Received ministerial level advice that no govt. guarantee available only assurance that govt. will stand by KR • KR has agreed to WACC and asset base therefore fee is a known quantity	**L**	
9	Commercial	Return not sufficient for investment or asset base not agreed	Parties cannot reach terms acceptable to both.	Escalation of dispute - mediation then arbitration. Potential Cent. Govt. intervention. Potential threat of compulsory acquisition. Commerce Commission	Working on principle of good faith negotiations. No legal reason to end in arbitration. See pressure for cent govt. Settlement agreement	H	**RISKS ADDRESSED** • Deal now imminent and provides attractive terms	**L**	
10	Commercial	Max exposure reached for PMNZ	PMNZ gearing ratios at max exposure due to project	Other opportunities not able to be pursued until ratios reduced	10 year budgets have 'business as usual' components - however major new projects would be difficult	H	**RISKS ADDRESSED** • Reduced investment profile no longer at max exposure	**L**	
11	Consenting Risks- Cultural Impacts	Cultural effects not suitably recognised	Poor engagement with iwi Failure to respond to iwi concerns Unexpected archaeological finds	Delays to consent approval Poor community response Delays to construction	Early engagement of CIA consultant and Archaeologist Early meetings to discuss importance of the site to iwi to get an idea of what they might want	M	**RISKS ADDRESSED** • Resource Consent approved • Kawanata with Te Atiawa signed • Ongoing engagement with iwi part of PMNZ project role	**L**	
12	High whole of life costs	Whole of life costs high due to operational and maintenance costs	Best solution not achieved with level of capital investment	Capital cost compromises result in higher operational and maintenance cost	Repair and Maintenance schedule (PMNZ assets) Alternative costs of sustainable options for terminal building, lighting, services	M	**RISKS ADDRESSED** • Design uses whole of life principles	**L**	
13	Programme delays	PMNZ infrastructure not completed on time - PMNZ holds risk i.e. non alliance	Challenging program affecting PMNZ ability to deliver infrastructure on time. Availability of contractors. Contractors resourcing / solvency. Unforeseen issues during project planning. Poor governance. Delays in governance decision. Act of God - COVID contractors from overseas etc.	PMNZ Infrastructure not ready for new vessels, KR cannot use facilities as planned. Liquidated damages ' contractual issues. Business interuption for KR. Reputational damage.	1) Working towards an alliance approach with KR and PMNZ as owner participants. Sunset date under alliance. 2) Risk allocation under the CRA - risks are being higlighted and allocated to KR as we work through.	H	**RISKS ADDRESSED** • KR deliver project • Fixed investment agreed • Current fee continues until completion • WACC paid on PMNZ investment	**L**	

14	Affordability and Funding	Outturn cost higher than agreed project cost	Procurement strategy does not align with cost certainty requirement. Unforeseen conditions / requirements. Future design phases (preliminary and detailed design) end up increasing costs from those anticipated/agreed from the concept design allocation. Programme speed means due diligence not fully completed.	Project not completed or not completed on time. PMNZ's asset costs higher than agreed funding. PMNZ forced to cover additional costs or to own fewer assets.	Current proposal is a fixed contribution offer by PMNZ for a 'group' of assets irrespective of actual cost in order to meet timeframes of KR. I.e. $140m contribution for terminal building, wharf, services and associated transitional berths. Fee is based on $140m, PMNZ own assets at end of construction irrespective of cost.	H	**RISKS ADDRESSED** • KR deliver project • Fixed investment agreed • Current fee continues until completion • WACC paid on PMNZ investment	**L**	
15	Frustration	Force Majeure during construction	Act of God	Programme delay or relocation of assets within Picton	Force Majeure is a topic for negotiation, including insurance	H	**RISKS ADDRESSED** • KR deliver project • Fixed investment agreed • Current fee continues until completion • WACC paid on PMNZ investment	**L**	
16	Frustration	Force Majeure during construction	Act of God	Project abandonment	Force Majeure is a topic for negotiation, including termination clauses	H	**RISKS ADDRESSED** • Concept of insurance cover during construction agreed • Concept of PMNZ will have step in rights agreed	**L**	Finalise detail of quantum of insurance cover & step in rights / sunset date
17	Procurement	Material Defect in the Assets	Poor contractor performance	Asset failure	Working on procurement strategy. Agree practical step in rights for the Owner Participant to ensure the project may continue despite material default by the main contractor, including the ability for the OPs to step in and/or to suspend/replace and terminate the main contractor.	H	**RISKS ADDRESSED** • Key terms include warranties during and after constructions • Concept of PMNZ governance role in project agreed	**L**	Finalise governance role and procedures
18	Frustration	Other Frustrating Events during construction	Tory Channel risk assessment.	KR cannot operate under current conditions - less financially viable. Abandon project	Working group with HM looking at 2 risk assessments and practical ways to reduce risk	H	**RISKS ADDRESSED** • Contractual frustration clauses as per above • Ferries purchased and KR committed to project • All parties working towards safe / sensible outcome for TC	M	Continue to work with Harbourmaster et al
19	Disruption	Port customers seek other services due to restrictions, interruptions or delays at Picton	Construction causes disruption that reduces the volume of freight and passengers using Interislander Construction causes disruption to Interislander and Bluebridge that results in shippers using coastal shipping Cruise companies use other ports due to restrictions at port/Shakespeare Bay Poor Passenger experience results in low/no growth KiwiRail development impacts on the PMNZ Master Plan development Construction and/or development restricts growth for Strait Shipping and other port users	PMNZ do not get expected ferry revenues KiwiRail lose customers and revenue PMNZ loses Cruise customers to other ports PMNZ misses opportunity for development with existing and new customers	Staging to allow operations to continue Investment in temporary facilities and construction staging to allow operations to continue Design considers PMNZ Port Master Plan	H	**RISKS ADDRESSED** • Transitional arrangements agreed (use of berth 2) • Minimal disruption anticipated	**L**	
20	Commercial	Rail becomes less relevant during construction period	Change in govt. strategy wrt rail. Technology moves to make rail less relevant	Infrastructure changes needed.	Negotiations focussed rail options.	M	**RISKS ADDRESSED** • Govt. committed to purchase new ferries. Plus additional investment in locomotives recently announced	**L**	
21	Counterparty	KR unable to pay lease	KR solvency relies on government input	PMNZ does not get paid and cannot meet debt obligations	PMNZ seeking securities from KR and letter to Ministers from Mayor seek SH guarantees	E	**RISKS ADDRESSED** • Reduced investment profile to reduce exposure to counter party risk. • Securities agreed – parent co guarantee plus bank guarantee • Received ministerial level advice that no govt. guarantee available only assurance that govt. will stand by KR • KR has agreed to WACC and asset base therefore fee is a known quantity	**L**	

22	Counterparty	Stranded assets	Depreciation term > contract term. Contract is not renewed. Existing assets are not suitable for next generation ferries	Stranded assets	Working to align depreciation term with contract term and include balloon payment for default	E	**RISKS ADDRESSED** • Depreciation is aligned to overall lease term Balloon payment agreed on strandable part of assets	**L**	Quantum to be finalised
23	Frustration	Contract breach	KR develop alternative to Cook Strait ferries during term.	Stranded assets, loss of revenue etc	Working on default clauses in contract	E	**RISKS ADDRESSED** • Reduced investment profile to reduce exposure to counter party risk. • Securities agreed – parent co guarantee plus bank guarantee • Received ministerial level advice that no govt. guarantee available only assurance that govt. will stand by KR • 6 month bank guarantee parent co guarantee. • No revaluation (pay back quicker) • Large investment in Picton by KR	**L**	
24	Counterparty	KR divest ferry arm of business	Change in government policy / strategy	Stranded assets	Ensure there are appropriate assignment clauses in place	E	**RISKS ADDRESSED** • Assignment clauses agreed in principle	**L**	Finalise assignment provisions
25	Frustration	Force majeure clauses/events (Wellington)	Act of God damages Wellington facilities or IIL ferry sinks	ILL ferries are not running because cannot load/unload in Wellington	Working on insurance for Act of God to be paid by KR	E	**RISKS ADDRESSED** • Agreed clause whereby KR continue to pay full fee	**L**	
26	Frustration	Force majeure clauses/events (Picton)	Act of God damages Picton facilities	PMNZ unable to service debt / go bankrupt	Working on insurance for Act of God to be paid by KR	E	**RISKS ADDRESSED** • Insurance cover agreed •KR pay cost of debt as per WACC model in interim	**L**	
27	Commercial	PMNZ is constrained on capital projects into the future	Debt and timing of project puts strain on PMNZ ability to investment in future CAPEX	Loss of future opportunity	Current proposal with cap on investment allows some incremental future investment	H	**RISKS ADDRESSED** • Lowered investment profile	**L**	
28	Commercial	Damage to infrastructure	KR operations damage PMNZ infrastructure	Damaged infrastructure - costs of repair or at extreme frustration of contract	None	H	**RISKS ADDRESSED** • Fee remains payable in full - R&M at KR cost	**L**	
29	Commercial	Disputes	Dispute during contract	Mediation, arbitration or court action	None	H	**RISKS ADDRESSED** • Dispute resolution agreed in lease	**L**	Finalise provisions in lease
30	Contractual	Improvements during term of contract	KR needs changes to assets	New CAPEX required	Ensure there are appropriate new CAPEX clauses	H	RISKS ADDRESSED **CRA AND KEY TERMS** include clauses for de minimis and major CAPEX requirements. New CAPEX approved by both parties. Capex included in new model based with depreciation based on the remaining like of the contract. Any improvements to PMNZ owned assets need to be approved by PMNZ. Improvements to PMNZ owned assets will also depend on the scale and remaining term of the contract. If it comes early on, or is small in value, then it can be dealt with in the BBM model. If significant, may be a new agreement	**L**	Finalise clause
31	Commercial	Changes in markets either increase direct costs of provision of services or inflation overtakes return.	Inflation not adequately dealt with in contract	Lower return over life of contract	Ensuring fee calculation includes appropriate inflation mechanism	H	**RISKS ADDRESSED** • Risk Free rate reviewed every 2 years on 10 year govt. bond • Full WACC review every 10 years - based on change of market criteria • OPEX passed through or reviewed regularly - includes any new OPEX over life	**L**	Finalise mechanism for OPEX pass through

Appendix 3 : Programme

ID	Task Mod	Task Name	Duration	Start	Finish
1		**iReX**	**1780 days**	**Tue 26/02/19**	**Fri 3/07/26**
2		**Picton Terminal**	**1780 days**	**Tue 26/02/19**	**Fri 3/07/26**
4		**Project Delivery & Overhead**	**1780 days**	**Tue 26/02/19**	**Fri 3/07/26**
49		**Picton Terminal - KiwiRail Delivered**	**834 days**	**Tue 26/02/19**	**Mon 11/07/22**
248		**Procurement of Design**	**47 days**	**Fri 24/09/21**	**Tue 30/11/21**
249		**RFT Release & Review by Tenderers**	**22 days**	**Fri 24/09/21**	**Tue 26/10/21**
250		Review of RFT by Tenderers	15 days	Fri 24/09/21	Thu 14/10/21
251		Deadline for Questions from Tenderers	0 days	Fri 15/10/21	Fri 15/10/21
252		KiwiRail to respond to Tenderers' questions	2 days	Fri 15/10/21	Mon 18/10/21
253		Deadline for Tender submission	5 days	Tue 19/10/21	Tue 26/10/21
254		**RFT Evaluate & Award**	**25 days**	**Wed 27/10/21**	**Tue 30/11/21**
255		Evaluation to Shortlist Tenderers	8 days	Wed 27/10/21	Fri 5/11/21
256		Notification of Shortlisting to Tenderers	0 days	Fri 5/11/21	Fri 5/11/21
257		Interview/presentation for Shortlisted Tenderers	2 days	Mon 8/11/21	Tue 9/11/21
258		Select successful Tenderer	8 days	Wed 10/11/21	Fri 19/11/21
259		Contract Negotiation	5 days	Mon 22/11/21	Fri 26/11/21
260		Contract Award	1 day	Mon 29/11/21	Mon 29/11/21
261		Onboarding of Successful Tenderer and Commencement of Des	1 day	Tue 30/11/21	Tue 30/11/21
262		**Design**	**190 days**	**Wed 1/12/21**	**Mon 19/09/22**
263		Package 1 - Temporary Works	90 days	Wed 1/12/21	Thu 28/04/22
264		Package 2 - Culvert	110 days	Wed 1/12/21	Thu 26/05/22
265		Package 3 - Ground Improvements	110 days	Wed 1/12/21	Thu 26/05/22
266		Package 4 - Rail	110 days	Wed 1/12/21	Thu 26/05/22
267		Package 5 - Utilities	110 days	Wed 1/12/21	Thu 26/05/22
268		Package 6 - Pavement	110 days	Wed 1/12/21	Thu 26/05/22
269		Package 7 - Structures	150 days	Wed 1/12/21	Mon 25/07/22
270		Package 8 - Buildings and EPW	160 days	Wed 1/12/21	Mon 8/08/22
271		Package 9 - Wharf	160 days	Wed 1/12/21	Mon 8/08/22
272		Design 25%	0 days	Tue 21/12/21	Tue 21/12/21
273		Design 50%	0 days	Thu 28/04/22	Thu 28/04/22
274		Design 85%	0 days	Thu 30/06/22	Thu 30/06/22
275		Design 100%	0 days	Mon 8/08/22	Mon 8/08/22
276		Issue Reviewed IFC	0 days	Mon 19/09/22	Mon 19/09/22
277		**Picton Terminal Gateways**	**206 days?**	**Mon 27/09/21**	**Mon 8/08/22**
278		Picton Terminal Assurance Gate 3 (Design) Preparation	15 days	Tue 19/07/22	Mon 8/08/22
279		*Picton Terminal approval of Assurance Gate 3 (Design)*	0 days	Mon 8/08/22	Mon 8/08/22
281		P3DA Gateway 1 – Concept Design Completion	1 day	Mon 27/09/21	Mon 27/09/21
282		P3DA Gateway 2 – Agree Programme and Asset Allocation	1 day	Mon 4/10/21	Mon 4/10/21
283		P3DA Gateway 3 – Agree Delivery Procurement plan and Key Terr	1 day	Fri 29/10/21	Fri 29/10/21
284		P3DA Gateway 4 – PMNZ Funding Secured	1 day	Mon 14/03/22	Mon 14/03/22
285		KR Enabling Works	0 days	Tue 1/03/22	Tue 1/03/22
286		P3DA Gateway 5 – Delivery procurement and award (Pending)	1 day?	Fri 1/04/22	Fri 1/04/22
287		P3DA Gateway 6 – Commercial Redevelopment Agreement (CRA) approved	1 day	Tue 29/03/22	Tue 29/03/22
288		KR Main Works Commence	0 days	Mon 8/08/22	Mon 8/08/22
289		**Picton Terminal Implementation**	**1055 days**	**Tue 1/02/22**	**Fri 3/07/26**
290		**Procurement - Materials**	**539 days**	**Tue 1/02/22**	**Tue 7/05/24**
325		**Enabling Works - Civil**	**450 days**	**Tue 1/03/22**	**Wed 24/01/24**
344		**Temporary Terminal**	**77 days**	**Tue 12/07/22**	**Thu 27/10/22**
348		**Enabling Works - Marine**	**136 days**	**Wed 18/05/22**	**Mon 28/11/22**
358		**New Terminal Building**	**655 days**	**Fri 28/10/22**	**Thu 7/08/25**
368		**Structures**	**400 days**	**Tue 20/09/22**	**Wed 5/06/24**
389		**Civil Yard Works**	**378 days**	**Wed 8/02/23**	**Thu 29/08/24**
402		**Rail works**	**215 days**	**Tue 24/10/23**	**Thu 19/09/24**
410		**Ground Improvement + Seawalls**	**374 days**	**Mon 28/11/22**	**Mon 8/07/24**
425		**Wharf Construction**	**466 days**	**Wed 23/08/23**	**Fri 8/08/25**
437		**Nesting Structure**	**300 days**	**Thu 16/11/23**	**Thu 6/03/25**
445		**Rail Linkspan Tie-ins**	**45 days**	**Fri 7/03/25**	**Tue 13/05/25**
447		**Contingency**	**91 days**	**Thu 8/05/25**	**Mon 15/09/25**
449		**Commission new ships**	**78 days**	**Mon 15/09/25**	**Wed 21/01/26**
453		**Decommission Site**	**80 days**	**Fri 23/01/26**	**Wed 20/05/26**
460		**Picton Terminal Assurance Gate 4 (Implementation)**	**13 days**	**Thu 30/04/26**	**Mon 18/05/26**
465		**Closeout**	**30 days**	**Thu 21/05/26**	**Fri 3/07/26**
466		**Picton Terminal - KiwiRail Closeout Activities**	**30 days**	**Thu 21/05/26**	**Fri 3/07/26**
467		Asset Data Updated	30 days	Thu 21/05/26	Fri 3/07/26
468		Handover to Operations / End User	30 days	Thu 21/05/26	Fri 3/07/26
469		Benefit Realisation	30 days	Thu 21/05/26	Fri 3/07/26
470		Post Project Review	30 days	Thu 21/05/26	Fri 3/07/26
471		**Picton Terminal Assurance Gate 5**	**15 days**	**Fri 12/06/26**	**Fri 3/07/26**
472		Picton Terminal Assurance Gate 5 Preparation	15 days	Fri 12/06/26	Fri 3/07/26
473		*Picton Terminal approval of Assurance Gate 5*	0 days	Fri 3/07/26	Fri 3/07/26
475		Project Completed	0 days	Fri 3/07/26	Fri 3/07/26



Project: iReX - Picton Terminal
Date: Wed 6/10/21

Task	Summary	Inactive Milestone	Duration-only	Start-only	External Milestone	Critical Split	Baseline Summary
Split	Project Summary	Inactive Summary	Manual Summary Rollup	Finish-only	Deadline	Progress	Baseline Milestone
Milestone	Inactive Task	Manual Task	Manual Summary	External Tasks	Critical	Manual Progress	

CASTALIA

Thinking for a better world.

Port of Marlborough New Zealand Limited
Attn: Rhys Welbourn

7 November 2021

Advice on Negotiation of Key Terms with KiwiRail

Dear Rhys

This is to confirm that the Castalia team—led by me and supported by our modellers and analysts—provided support to PMNZ in reaching agreement on the Key Terms for the KiwiRail Comprehensive Redevelopment Agreement and Lease and License for the Waitohi Ferry Precinct redevelopment.

Our advice focused on enabling PMNZ achieve the best possible deal given the constraint imposed by the terms of the Settlement Agreement. Under the Settlement Agreement, PMNZ and KiwiRail agreed that the key commercial terms for the redevelopment will be based on the Commerce Commission's input methodologies.

The Commerce Commission applies the Input Methodologies to calculate the allowed return for the gas, electricity and airport sectors. For each sector, the return is calibrated to the level of risk faced by the operator in that sector.

Our approach to advising on the negotiations was to achieve as much de-risking as possible, while using whatever flexibility allowed under the Commerce Commission's approach to secure the highest possible WACC usually consistent with a higher level of risk. In other words, our advice was that the best way to create value in the negotiations was to create a wedge between risk allocation and WACC.

In our view, the outcome of the negotiations as reflected in the Key Terms represents a good outcome for PMNZ. On the one hand, the agreement achieves maximum possible risk transfer from PMNZ to KiwiRail:

- PMNZ revenue is not exposed to any volume fluctuations faced by KiwiRail
- PMNZ operating, repair and maintenance costs are directly passed through to KiwiRail

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- PMNZ is not exposed to construction cost or timing risks
- PMNZ is largely protected from Force Majeure events
- PMNZ is protected from asset stranding risk through termination payment obligations on KiwiRail
- PMNZ will have some security in the event of non-payment by KiwiRail.

When compared to the sectors regulated by the Commerce Commission, this represents the greatest degree of risk transfer to the user. From the perspective of the service provider, the lowest risk among the regulated sectors is faced by electricity distributors, who enjoy significant monopoly power and generally can expect to recover their revenue requirement (gas and airports face higher risks, either in the form of asset stranding or through revenue variability). However, even electricity distributors face some revenue variability. Even more importantly, the Commerce Commission exercises close supervision over their CAPEX and OPEX, which may result in some costs being optimised by the regulator and not being able to be passed on to users.

While securing the lowest level of risk, PMNZ were able to secure WACC which is relatively high by comparison with other regulated sectors. For example, for the electricity distribution companies, the Commerce Commission allows the equity beta of 0.6. For the level of leverage proposed for the agreement with KiwiRail, this would have translated into an asset beta of 0.36. In fact, this was close to the initial position adopted by KwiRail. Given that starting position, and the risk allocation achieved, we believe that the asset beta of .....achieved through commercial negotiations with KiwiRail represents a good outcome. A further advantageous departure from the Commerce Commission input methodologies secured through negotiations was the agreement to use 10-year government bond rate as the basis for calculating the risk-free rate, rather than the 5-year term to maturity used by the Commerce Commission. In general, longer term bond rates tend to be higher. Using longer maturities also provides PMNZ with greater flexibility to match the terms of its borrowing to the benchmark cost of debt used in the WACC model.

Overall, we believe that the strategy of opening the value wedge by driving de-risking as aggressively as possible while keeping WACC to the top end of the range contemplated by the Commerce Commission was consistently and successfully implemented by the PMNZ negotiating team.

Yours sincerely,

Alex Sundakov
Executive Director
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