

26 August 2020

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**Hon Phil Twyford**  
**Minister of Transport**

## NEW ZEALAND UPGRADE PROGRAMME UPDATE - AUGUST 2020

### Purpose

Update you on recent work and findings following further investigations of the New Zealand Upgrade Programme (NZUP) transport projects.

### Key points

- We are currently working with Waka Kotahi NZ Transport Agency (Waka Kotahi) and KiwiRail to establish oversight arrangements for the NZUP programme. Waka Kotahi and KiwiRail are both working well with the process, and we are very supportive of the work they are doing to establish arrangements for programme delivery.
- It will be some time before there is a reliable forecast cost for the programme. Current estimates by the Ministry's technical advisers simply illustrate the order of magnitude of cost risks that are materialising, but at this early stage suggest cost escalation at a level above 15–20 percent, against a programme contingency of less than 1 percent.
- We will work with Waka Kotahi and KiwiRail to provide further advice in December 2020, with assistance from the Oversight Group that has been established for the programme. It may be early 2021 before advice can be provided on how cost, scope and benefits can be baselined, and potential options to manage the programme given funding constraints and cost pressures.

### Recommendations

We recommend you:

- |   |   |          |
|---|---|----------|
| 1 | <b>refer</b> this briefing to Hon Grant Robertson, Minister of Finance. | Yes / No |
|---|---|----------|

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 Bryn Gandy  
**Deputy Chief Executive, System  
 Strategy and Investment**

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 Hon Phil Twyford  
**Minister of Transport**

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Minister's office to complete:

Approved

Declined

Seen by Minister

Not seen by Minister

Overtaken by events

Comments

Contacts

Name	Telephone	First contact
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## NEW ZEALAND UPGRADE PROGRAMME UPDATE - AUGUST 2020

### We advised you on the Establishment Reports in July 2020

- 1 The Ministry and Treasury provided you and the Minister of Finance with advice on the Establishment Reports, which sought to form the baseline costs and scopes for the NZUP transport projects (OC200503 / T2020/2205 refers). We noted some remaining uncertainty around the details in the Establishment Reports.
- 2 You will next receive advice following the first 'full agenda' meeting of the NZUP Oversight Group in a few weeks' time. The Oversight Group's Chair, Brian Wood, has agreed that this briefing should be provided in the interim and the Oversight Group has been consulted on its content.
- 3 Waka Kotahi and KiwiRail have also been consulted, and agree that the issues it highlights should be raised.

### Recent cost and scope risk estimates for some projects exceed allocations

- 4 Both Waka Kotahi and KiwiRail are working well, including with Ministry officials, to establish effective arrangements for NZUP programme delivery. We are very supportive of the work they are doing together and with the Ministry, including to establish clarity on NZUP programme costs, scope and anticipated outcomes and benefits.
- 5 Our previous advice highlighted the potential for cost risks, in particular with \$250–\$300 million required to extend the scope of the State Highway 1 Papakura to Drury South project. In August 2020, Ministers requested that Waka Kotahi provide advice on the impact of Stage 2 not being included as part of the scope of this project, a detailed breakdown of costs, and possible options to meet the additional costs and assessment of any impacts on the programme.
- 6 As the programme gets underway, the agencies are refining the scope and expected benefits of the programme, as well as its forecast cost. Early-stage estimates by the Ministry's technical advisors, based on conservative assumptions, are that cost escalations in the programme are likely to be at a level above 15–20 percent of the 10 year fixed funding envelope of the programme. The \$6.8 billion funding envelope includes a programme contingency of less than one percent to meet these and any further costs.
- 7 The Ministry, Waka Kotahi and KiwiRail emphasise the early stage of this estimate, but that it illustrates the order of magnitude of the real risks that are materialising in the programme. Work to refine the cost estimates is being carried out across the agencies, and will be assisted by the Oversight Group that has been established for the NZUP transport projects. Officials must make you aware of these issues in line with the 'no surprises' principle.

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- 8 We are seeing increasing projected costs arising from:
  - 8.1 further pre-implementation work identifying costs exceeding the 2019 estimates
  - 8.2 cost escalation updates to best reflect future construction (labour and material) and property costs
  - 8.3 potential project scope changes (e.g. elements that may be needed to deliver projects, but were not part of their original scope).
- 9 While COVID-19 may impact the above and other elements of the NZUP programme, current cost estimates do not include COVID-19 impacts. These are still to be worked through by Waka Kotahi, KiwiRail and officials.
- 10 The original project cost estimates reflected that projects were in early pre-implementation stages. Waka Kotahi was aware that there would be some inflation of costs, but because some contingency was built into each project (around seven percent per project), it expected that while challenging, it could deliver the programme within the fixed \$6.8 billion allocation.
- 11 Most projects required, and many still require, detailed business cases, additional design work, stakeholder engagement and geotechnical investigations, which could result in further significant changes to cost estimates and scope.
- 12 Costs relating to future decisions to extend project scope need to be managed carefully. We are working with Waka Kotahi and KiwiRail to ensure that the programme:
  - 12.1 aligns with Ministers' expectations
  - 12.2 delivers the outcomes and benefits sought
  - 12.3 remains as affordable as possible.

**There is insufficient programme contingency to fund the estimated cost increases**

- 13 We advised during the development of the NZUP that it would be prudent to leave some contingency across the programme to help to manage potential increases. This was because the Crown agreed to a fixed funding envelope of \$6.8 billion and the final programme contingency of \$42 million was not likely to be sufficient given the level of risk identified, particularly as we were working with some projects in their early stages of development.
- 14 The NZUP is different to the way Waka Kotahi delivers projects in the National Land Transport Programme (NLTP) as the NZUP must be managed by the agencies within its total \$6.8 billion funding envelope.

15 [Redacted text block]

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- 16 For some NZUP projects, the cost estimate was calculated before the pre-implementation steps (such as detailed business cases) were complete. For typical NLTP projects, cost increases at early stages in a project's life would mean reassessing the priority of the project and adapting the scope or funding accordingly. Given the adaptable approach within the NLTF relies on additional funding being available, this is not possible for NZUP, where projects must be delivered within a fixed cost envelope, with scopes that align with Ministerial expectations.

### **There are options for managing cost increases but these will require trade-offs**

- 17 In early 2021, the agencies will have a better understanding of the underlying fundamentals of cost and scope changes over time as the agencies seek to bring the programme to a point where it can be baselined.
- 18 A baselined programme will still change over time, but it will mean there is an agreed view across the programme of a feasible timing, cost, scope and benefits, in which the agencies and Ministers have a high enough level of confidence of delivery within the fixed funding envelope for the programme. Changes to the baseline will then require the agreement of Ministers and the agencies.

#### *Cost increases could be managed by refining the scope of the projects*

- 19 The early 2021 advice will include options to refine the scope of projects to ensure they are affordable across the programme's funding envelope. This could include removing projects from the programme to make funding available, or re-scoping elements of individual projects. As purchaser of the projects, you and the Minister of Finance will need to agree to any significant changes to their scope.

#### *Additional Crown funding could be committed*

- 20 If it is determined that a decision to increase cost or scope could represent value for the Crown, the Crown could consider providing additional funding.
- 21 A Crown commitment to meet additional funding requirements would provide certainty to progress the programme. Increased appropriations and the associated trade-offs would need to be considered through a future budget process.

#### *The NLTF is unlikely to have sufficient flexibility to meet increased costs*

- 22 The January 2020 advice noted the potential to consider funding from the NLTF to support cost increases. Since that advice, COVID-19 has created pressures (through reduced revenue, and requiring future repayments to repay COVID-19 debt). The NLTF is under significant pressure, and as a result no flexibility has been built in to GPS 2021. We also understand that it is unlikely that fuel excise duty and road user charges will be raised in the near term.
- 23 A 15–20 percent increase in NZUP costs is roughly equivalent to all NLTF 'discretionary' spending (all funds available for non-maintenance, debt repayments or initiatives and projects that are already commenced/committed) nationwide, for a year. The Waka Kotahi Board could consider funding parts of projects that align with the GPS priorities, but this may be minor in the scheme of the programme.

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- 24 A formal amendment to GPS 2021 would be needed to make any substantial level of funding available for NZUP roading projects. This would reprioritise funds away from other outcomes the Government is seeking from GPS 2021 or programmes it has publicly committed to, and may also require consultation and feedback from stakeholders in order to achieve this.

**The Oversight Group will provide regular updates on progress**

- 25 The NZUP Oversight Group has been established, and agrees that the issues identified, particularly around cost and scope will be challenging to resolve. It has emphasised the importance of bringing the programme to a point where there is a baselined view of timing, cost, scope and benefits.
- 26 In order to provide confidence to Ministers of possible options, we will need to work closely with Waka Kotahi and KiwiRail to firm up the project details and costs in order to provide the next baseline update following the Establishment Reports.
- 27 As well as its ongoing monitoring and assurance across the programme, we intend to use the Oversight Group and its expertise in forming our advice. The Oversight Group meets monthly, and will provide regular reports to Ministers. We will seek to provide an assessment of the programme before Christmas, though we expect it will be the New Year before options can be presented.

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