

4 March 2021

OC210094

Hon Michael Wood
Minister of Transport

Action required by:
Monday, 8 March 2021

cc Hon Grant Robertson
Minister of Finance

New Zealand Upgrade Programme February 2021 update

Purpose

Provides an update on progress of the New Zealand Upgrade Programme (the Programme) to 31 December 2020, and proceedings of the Programme's 10 February 2021 Oversight Group (the OSG) meeting.

Key points

- Discussions at the February 2021 OSG meeting focused on baselining progress, with an update on the Programme's forecasted cost increases. The OSG also discussed its role in the baselining process, which is to assure the processes, methodologies, breadth and consistency of baselining information, and support the Ministry of Transport (the Ministry) and the Treasury in their role of advising you on the Programme.
- The OSG considered information reported by the delivery agencies up to 31 December 2020, as well as progress that has been made since.
- Based on information up to 31 December 2020 (which has been overtaken by the baselining process), the OSG conservatively estimates that the Programme could exceed its available budget of \$6.8 billion by approximately \$1.9 billion or 28 percent. The conservative nature of the estimate reflects that the OSG's core role is to monitor the programme against its baseline (of scope, cost and schedule commitments), which was not well defined by the original Establishment Reports.
- The OSG recommended the current baselining process to provide you (as purchasers) and the delivery agencies with a comprehensive and enduring foundation for the Programme. Waka Kotahi and KiwiRail have made progress towards establishing more

robust project baselines. The OSG also welcomed the opportunity to attend baseline “challenge sessions”¹ held by delivery agencies.

- Good progress has also been made in improving the level of integration between governance at the delivery agencies, and the monitoring of the Programme. Agreement was reached over the past two weeks to share baselining information as it is developed, instead of waiting for approval by delivery agencies’ governance boards.
 - Through the baselining process, Waka Kotahi advised officials that its component of the Programme is facing **a further significant increase in forecasted costs, beyond the \$1.9 billion we previously estimated**. Waka Kotahi has indicated it would like to brief you directly on the detail of this increase, rather than having this information reported through the OSG process in the first instance.
 - Waka Kotahi advises that the further cost increases in its projects are driven by a range of factors over and above those reported to the OSG previously, including:
 - around \$800 million in cost escalations in relation to property acquisitions, that reflects unexpected movements in property markets, and greater property requirements for projects, since early 2020
 - developing fresh baselines on current day standards and assumptions. Older project information was sometimes relied on for the costings made in 2020, with very small contingencies incorporated. This has been overtaken by changed standards, consenting, technical requirements and costs
 - [REDACTED]
 - [REDACTED]
 - [REDACTED]
- Free and frank
- Delivery agencies are working to help you establish a deliverable programme, that best reflects your preferred outcomes, within the Programme’s funding envelope.
 - To assist you in making prioritisation decisions, and address the Programme’s cost challenges, officials have advised that you will be receiving three tranches of advice up to early April 2021 (OC210108 refers). This includes the OSG monthly report (this briefing), advice on a prioritisation approach for the Programme next week, and an assessment of the baseline in early April 2021.
 - Through the Weekly Report, officials will provide an update this week on what baselining information has been received to date, how the overall process is tracking, and other information that you will need to know on a ‘no surprises basis’. Officials will also, through Weekly Reports, regularly inform you on progress in establishing the baseline.

¹ The “challenge sessions” are workshops to test the quality and consistency of project information developed to date. The workshops were attended by a range of stakeholders from Waka Kotahi and KiwiRail, including technical discipline leads, and project directors as well as selected OSG members, officials, and independent advisers.

Recommendations

We recommend you:

- 1 **note** that based on data up to 31 December 2020, the OSG conservatively estimates that the Programme could exceed its available budget of \$6.8 billion by approximately \$1.9 billion or 28 percent
- 2 **note** that Waka Kotahi has advised us that its component of the Programme is facing a significant increase in forecasted costs, beyond what has been estimated by the OSG, and has indicated it wishes to brief you directly on the details of this change
- 3 **note** that officials will be providing further advice on Programme prioritisation and advice around the assessment of the Programme baseline, next week and in early April 2021 respectively.

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

Hon Michael Wood
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

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Protect the privacy of individuals

New Zealand Upgrade Programme February 2021 update

10 February 2021 New Zealand Upgrade Programme Oversight Group (the OSG) meeting

Discussions at the last OSG meeting focussed on baselining progress, with an update on the magnitude of expected cost increases for the Programme

1. At the 10 February 2021 Oversight Group (OSG) meeting, members of the OSG were updated on the current status of the New Zealand Upgrade Programme (the Programme), progress on developing a robust baseline for the Programme, and on advancing the Programme itself.
2. Advice provided in this briefing is based on information presented and discussed at the February 2021 OSG (up to 31 December 2020), and insights from OSG members. The fast-moving nature of the Programme means that project-level information in this report is already being superseded. Officials will use the most up to date information we have when we report to you over the next months.

The OSG's role in the baselining process is to assure the processes, methodologies, breadth and consistency of baselining information

3. The OSG discussed its role in both monitoring the Programme, and providing assurance over the establishment of the baseline. The baseline sets out what you as the purchase Ministers have bought in terms of scope and outcomes, and when and for what price it will be delivered. Your confidence in this information is a key factor in deciding how you would like to manage risks and choices as the projects are delivered.
4. The OSG reconfirmed their role in the baseline development process at the February 2021 OSG meeting. The OSG's role is to provide assurance as to whether the baselining information is complete and consistent, and appropriate processes and practices have been undertaken in developing scope, cost, schedule and risks as part of the baselining process.
5. The OSG's monitoring role is focused on the delivery of the Programme, and the development of the Programme baseline. Its advice is separate from the Ministry and Treasury's respective governance and performance monitoring roles in respect of Waka Kotahi and KiwiRail.
6. Care has and will continue to be taken to leverage assurance work undertaken by delivery agencies, and to avoid duplication. This work will support the Ministry of Transport (the Ministry) and the Treasury to provide advice on the overall level of confidence in individual projects and the Programme. This will include our best advice on purchase arrangements that will secure the outcomes you are seeking, and support you to manage cost and other risks that will remain with the Crown as purchaser.
7. Officials will be in a position to deliver the baseline review and advice to you by the first week of April 2021 (OC210108 refers).

Programme update

A number of changes occurred across the Programme since the most recent December 2020 update, in relation to the Programme's overall cost, schedule, and scope

8. Analysis of data provided by Waka Kotahi and KiwiRail (the delivery agencies) at the February 2021 OSG indicate that the Northern Pathway project cost increased for a third time, this time by \$90 million.² The total cost of the project is now estimated to be at \$600 million. No further detail was provided within Waka Kotahi reporting on why this was the case, although it is understood that the project team will come to the March 2021 Waka Kotahi Board meeting to discuss a revised scope for the project.

Property costs poses a significant risk to the overall Programme

9. Property and land acquisition requirements are likely to increase significantly over the quantum presented in the original Establishment Reports. This is primarily because preferred options are now better understood, more detailed work had been undertaken on projects, as well as unexpected movements in property markets since early 2020.
10. Property risks apply to projects being delivered by both delivery agencies, but the largest proportion of cost risks lies with Waka Kotahi.
11. Property acquisitions funded by the Crown are treated differently than other expenses because the risk is retained by the Crown. Therefore, property disposal profits and costs, should the Crown decide to sell unneeded property, also impact the Crown.
12. However, the financial net impact on the Crown may therefore be less significant once any property disposal profits are accounted for and returned to the Crown to offset Programme costs.

Schedule delays have also been reported across a number of projects

13. Physical works on the State Highway 58 project commenced in December 2020, which is around four months behind schedule. It is understood that a number of cumulative delays, including COVID-19, may have impacted the project's schedule.
14. KiwiRail's two most advanced projects (Wiri to Quay Park, and Papakura to Pukekohe) incurred some delays due to Auckland Rolling Contact Fatigue issues (wear and tear on rail infrastructure).
15. The urgent work programme to remediate these issues was prioritised during the Christmas 2020 period, with a consequential impact on work for other projects (including Wiri to Quay Park and Papakura to Pukekohe).
16. KiwiRail has limited opportunities throughout the year to undertake work on parts of the network that provides regular rail services. These opportunities are generally during public holidays. This means that small delays can impact delivery schedules significantly as major works may need to wait until the next block of line, which can be several months away.

² This was the only estimated cost increase reported by the delivery agencies during December 2020.

17. KiwiRail shared a plan with the OSG to undertake increased work through 2021. This includes longer block of line periods to speed up delivery of both Wiri to Quay Park and Papakura to Pukekohe Electrification to bring the projects back on schedule.
18. A scope change to transfer a 2 kilometre section of Takitimu North Link Stage 2 to Stage 1 has been proposed. The project is awaiting specimen design of this scope change, due in late March 2021, at which point an estimated cost will be available. It is understood that this would result in improved benefit realisation by better connecting the project into the transport network and allow benefits to be realised more quickly.

Programme baselining

Delivery agencies have agreed to share baselining information early

19. Delivery agencies previously indicated that baselining information would be provided, all at once after approval by the agency Boards, at the end of March 2021 (for Waka Kotahi) and the beginning of April 2021 (for KiwiRail).
20. Agreement was reached over the past two weeks to share baselining information as it is developed. Waka Kotahi has agreed to provide this information iteratively, and initial baselining information is already arriving in tranches.
21. Waka Kotahi has shared baseline reports covering seven out of its twenty projects, including Mill Road, Papakura to Drury South, and Takitimu North Link Stage 1. Independent advisers are currently undertaking a rapid review of the information and highlighting clarifications with Waka Kotahi where required.
22. Given the challenging timeframes, Waka Kotahi is having to provide us with baseline information that may be incomplete, and has not gone through internal sign-off and QA processes. Officials are working collaboratively with delivery agencies on identifying and addressing gaps in baselining information, and we will keep you updated on how this progresses.
23. KiwiRail plans to share baseline reports covering three of its six projects by 5 March 2021, with the remaining three by 12 March 2021. KiwiRail is presenting the latter three baseline reports at a challenge workshop on 4 March 2021. Officials should be in a position to report back on the completeness of KiwiRail's baseline information next week.

The OSG welcomed the opportunity to attend baseline challenge workshops held by Waka Kotahi and KiwiRail

24. Waka Kotahi held baseline challenge workshops on 2 and 4 February 2021 to test the quality and consistency of project information developed to date. The workshops were attended by a range of stakeholders from Waka Kotahi, including technical discipline leads and project directors, as well as selected OSG members, officials, and independent advisers.
25. The Waka Kotahi challenge sessions formed part of a process developed by the Waka Kotahi programme management team to provide assurance over the baselining work, and ensure consistent, quality information is used across the Programme.

26. KiwiRail held a similar session on 22 February 2021, which was attended by an official from the Ministry, and independent advisers. As noted earlier, another KiwiRail challenge workshop will be held on 4 March 2021.
27. The OSG welcomed the opportunity to attend the challenge sessions. The discussion was free and frank, enabling robust analysis of the risks and issues, as well as identifying a way forward to address OSG questions and comments.

The baselining process has identified significant cost increases in the Waka Kotahi projects which are driven by a range of factors, some of which will not be resolved through the current baselining process

28. Independent advisers previously estimated that the total cost of the Programme could eventually exceed the \$6.8 billion funding allocation by around \$1.9 billion.
29. This conservative estimate reflected that a number of elements in the projects, such as their cost, scope and schedule, were not fully resolved through the Establishment Reports. A baselining process has been needed to understand these issues clearly.
30. A number of factors are driving the cost increases, including scope changes, construction price inflation, and property considerations. New identified increases include the impacts of unexpected inflation in property costs (estimated at \$800 million), and changes in design standards and project costs since designs and business cases were originally developed.
31. Waka Kotahi indicated when projects were purchased that it had made allowances in its cost estimates to account for a range of pressures. Following further work on the projects, Waka Kotahi advised that a much greater level of contingency will be needed.

32. [REDACTED]
[REDACTED]
[REDACTED]
[REDACTED] Free and frank

33. The OSG's independent advisers have been working closely with KiwiRail, sighting various baseline documents and providing guidance through the process. A collaborative relationship has been developed and this has assisted in creating a 'no surprises' environment, which is expected to result in a more robust baseline.

Next steps

34. Officials have advised (OC210108 refers) that you will be receiving three tranches of advice up to early April 2021:
 - New Zealand Upgrade Programme OSG February 2021 update (this briefing)
 - advice on Programme prioritisation, next week
 - assessment of the Programme baseline, in early April 2021.

IN CONFIDENCE

35. Work on the other two tranches of advice (prioritisation and baseline advice) is well underway. Officials will also regularly inform you on baselining progress through the Weekly Report.
36. Officials remain confident that the baseline review and advice will be ready to share with you in the first week of April 2021, assuming reports and associated information are provided within the agreed timeframes. While we can provide advice in this timeframe, our confidence in the baseline will be dependent on the quality of information we receive.
37. The next OSG meeting is currently scheduled for 15 April 2021.

Proactively released
by the Ministry of Transport