

# TAHE: Long-term operating model assessment

NSW Cabinet in Confidence

8 November 2020

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Level 38 Tows These 300 Balangairo Avanua Sydney NSW 2000

P O Box H67 Australia Square Sydney NSVV 1213 Australia ABN 51 194 660 193 Telephone +61 2 9335 7000 Facsinine +61 2 9335 7001 DX: 1059 Sydney www.kpmg.com.au

Rodd Staples Secretary Transport for NSW 16 Lee Street Chippendale NSW 2008

8 November 2020

Dear Secretary,

KPMG has been delighted to assist TfNSW with the definition of a complex, long-term operating model for TAHE – and its careful assessment against Cabinet's objectives.

Our report is in final form and supersedes draft versions of this report.

# TAHE long-term operating model:

I am pleased to confirm that we have successfully developed a workable operating model for TAHE, designed to conserve TAHE's budget treatment and safely allocate operational and legal accountabilities.

#### **KPMG TAHE Financial Model**

As you are aware, in our June 2020 report to Cabinet we raised a range of limitations impacting the estimates and modelling of TAHE's financial performance.

As per Cabinet's decision and our responding scope, we have spent considerable time developing a much more detailed and robust financial model.

This provides Cabinet the opportunity to better understand the overall impacts and benefits offered by TAHE.

# **Issues for Cabinet:**

The enclosed report represents the deepest work to date to clearly segment and allocate key functions between transport agencies and TAHE; and to clearly model and analyse TAHE's net impacts.

Naturally, this deeper interrogation has identified a range of issues that should be considered by Cabinet – when TAHE returns for further consideration in November. We have outlined our views on these challenges, following the executive summary.

As you are aware, this has been a technically complex engagement, with equally complex stakeholder overlays.

Through you I would like to extend my warm thanks to the dedicated TfNSW officials who generously contributed their deep expertise and professional courtesy to me and to my team.

In anticipation, we look forward to continuing to support you on TAHE and on other transport initiatives.

Yours sincerely,

Brendan Lyon Partner

# Executive summary

This report outlines a long-term operating and financial model for the Transport Asset Holding Entity (TAHE), which commenced transitional operation on 1 July 2020.

# Introduction

TAHE's long-term operating model requires the most fundamental structural change to the NSW railways, since the mid-1990s.

This sees TfNSW cede control over:

- The level and terms of access pricing to public and private rail access seekers;
- The level and terms of investment into rail capital projects (track, trains etc);
- The level and terms of investment into non-rail capital projects (ISDs, car parks etc); and
- The endorsement of the level of maintenance expenditure on rail and non-rail assets, and assurance that it has been appropriately performed.

TAHE's long-term operating model has been developed to meet Cabinet's objectives, outlined in Figure 1 below – and with assessment undertaken in **Section 4**. Our methodology, outlined in **Appendix 2**, has been based on detailed research and analysis, overlaid by continuous and detailed consultation with NSW Treasury, TAHE and TfNSW.

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Where inconsistency has arisen between objectives, we have sought to prioritise safety and then fiscal objectives over others; reflecting their binary nature.

This report necessarily makes observations or assumptions regarding safety, legal and accounting matters – reflecting our scope and Cabinet's requirements. For clarity, this report does not provide safety, legal or accounting advice or opinion.

The financial modelling and detailed analysis in this report is derived from the 'KPMG TAHE Financial Model'. This model was developed by KPMG to address the modelling limitations identified in our June 2020 report to Cabinet – and responding to Cabinet's request for a deeper, more accurate projection of TAHE's overall costs and benefits over time.

# TAHE's operating model

The long-term operating model sees TAHE as an independent, mature corporation that exists to commercially meet its objectives as the owner of the State's regulated rail network, unregulated rail assets and substantial adjacent non-operational land holdings.

Sustaining TAHE as a PNFC is fundamental to Cabinet's fiscal objectives. Treasury advice and consultations confirm that TAHE must have demonstrable independence and control of its assets, revenues, investments and costs.

TAHE's assets as of 1 July 2020 are outlined below.

Table 1: Summary of TAHE's assets

TAHE's total assets

\$40.0 billion







Land and Earthworks \$11.1 billion



Electrified Network \$3.1 billion



Rail Signalling Systems \$2.0 billion



Network Control \$0.5 billion

## Subtotal - Regulated assets



Stations & Facilities

\$10.1 billion







Depots & Yards \$0.5 billion



\$26.3 billion

Property Portfolio \$0.3 billion

#### Subtotal - Non-regulated assets



Cash and other current assets \$0.1 billion

#### Subtotal - Cash and other current assets

\$0.1 billion

\$13.6 billion

Source: NSW Treasury forecasts found in PRIME, May 2020

The operating model contemplates TAHE with independent control over four areas:



Access and license arrangements for rail assets



Operational and non-operational capital projects



Endorsement of maintenance level



Corporate Finance and Funding



# Access and licence arrangements for rail assets

The regulated rail network is the largest asset on TAHE's balance sheet – carried at a DORC value of \$26.3 billion; but it is also the largest driver of TAHE's costs, with annual capital, operating and depreciation costs modelled at an average of \$1.6 billion per annum over the next 10 years.

To meet its objectives, TAHE will reintroduce access charges levied to the public rail operators commencing from FY22 at \$700m.

Access fees have not been imposed on the public rail operators since prior corporatisation was progressively dismantled, from the mid-2000s; but have continued to be imposed on other access seekers – for example, freight operators.

Access fees are regulated by IPART, under the NSW Rail Access Undertaking. The NSWRAU requires that TAHE's access fees are negotiated between a determined 'floor' and 'ceiling'.

To assist Cabinet to better understand TAHE's impacts, our more detailed financial model has allowed us to calculate IPART's regulated floor and ceiling prices and thereby, the additional cost to the operators.

## KPMG | iv

Access fees will be negotiated between TAHE and the operators, in future years. In the interim, KPMG have calculated a floor and a ceiling and NSW Treasury have recommended an assumption that they will commence at \$700m pa for FY21/22 to FY23/24, then increase onwards<sup>1</sup>. Notably, KPMG estimates show that TAHE is non-compliant with the floor test in FY21, subject to IPART determination<sup>2</sup>.

Price	Value
Public operator access floor (minimum) price:	\$1.41 billion
Public operator access ceiling (maximum) price:	\$4.34 billion

The introduction of access charges to the public operators is the key reason for the deterioration of estimated budget performance under both TAHE scenarios, discussed below and in **Section 2**.

Importantly, while TAHE will determine the commercial aspects of rail access, TfNSW retains control over the Standard Working Timetable, under the TAA; while the Network Controller determines the Daily Working Timetable – who remains a statutory appointee of the Minister.

TAHE does not have operational control of the network; but within the bounds of the NSWRAU, the corporation does have independent control over the level of new access charges imposed on public rail operators and the budget; and over contracts with private rail access seekers.

# 2

# Operational and non-operational capital projects

The operating model sees TAHE with independent control over all rail infrastructure projects within the constraints of economic and safety regulation but TfNSW maintains its role in the integrated strategic planning assessment before business case development. The SOC Act and TAA provide an ability for TAHE to be directed, but it must be financially compensated for net costs with directions reported to Parliament.

Noting the fiscal objectives, TAHE must have control and choice over what it does with its assets and investments; meaning it must have independent control over rail operating and non-operating capital projects. This sees TAHE assume decision rights over following types of projects outlined in Table 3:

Table 3: Overview of TAHE capital project types

Regulated operational	Network capital investments (e.g. More Trains, More Services (MTMS) 3)			
Unregulated Operational	Rolling stock investments (e.g. Regional Rail Rolling Stock PPP)			
Unregulated Operational	Local station upgrades (e.g. Dubbo Station Upgrade)			
Unregulated Operational	Commuter car parks (e.g. West Ryde Commuter Car Park Program)			
Unregulated Non-operational	Place making and ISDs			

<sup>&</sup>lt;sup>1</sup> Communicated to KPMG via phone call from Anne Hayes on 14/10/2020.

<sup>&</sup>lt;sup>2</sup> KPMG financial modelling shows that TAHE breaches the NSW RAU and the resulting IPART determined price floor in FY21. This is because rail operators should have commenced paying access fees since TAHE stand up on 1 July 2020 – and access fees should be above the estimated floor of \$1.4bn in FY21. Implicitly, Sydney Trains as the Network Controller and O&M on the MRN incurs costs which are almost equivalent to the floor, but NSWT does not incur these same costs nor does it pay for Access.

As noted in the illustration above, we have segmented between TAHE's operational/non-operational and regulated/unregulated capital projects. These segmentations have been adopted to allow the long-term operating model to adequately address the complex overlays created by economic and safety law and regulation.

For these reasons, the long-term operating model excludes TAHE from accountability or responsibility for operational rail projects during procurement and delivery. This reflects advice from TfNSW's Safety Environment and Regulation Division in order to maintain the Operators as the RIM and to be clear on legal accountabilities under RSNL.

An unresolved issue is the liability for variations in scope and cost overruns between TfNSW, other transport agencies and TAHE.

# 3

## Endorsement of maintenance level

There are a number of agreements required to be established between entities over time. The yet to be developed agreement will articulate and agree asset condition outcomes based on the asset standards set by TfNSW, providing TAHE confidence that the maintenance expenditure supports the standard requirements. A Private Contractor will be responsible for undertaking maintenance activity for the CRN.

Capitalised maintenance is accounted for on TAHE's balance sheet under a fee for service arrangement; while operating maintenance reduces the access charges paid to TAHE for the MRN and is recognised as an expense by TAHE for the CRN. The operating model contemplates that capital maintenance funding forms a component of TAHE's equity funding, which is then payable to appointed maintainers through a fee for service model. This may change depending on TAHE's corporate strategy.

While TAHE endorses the quantum – it has no involvement in the allocation of maintenance funding, which is performed solely by Sydney Trains/TfNSW.

TAHE is accountable for assuring itself, via its own Asset Assurance Framework, that its standards are being met and its funding is being appropriately applied.

This construct has been developed through consultation between TAHE and TfNSW and is designed to provide TAHE with required control and independence, while ameliorating the safety risks that can be created where maintenance approval and performance are structurally separate.

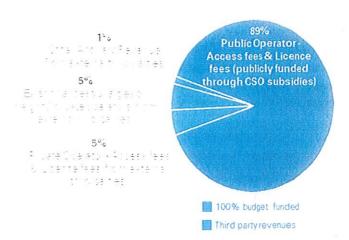
For further detail, see the TAHE Asset and Safety overview letter written by TfNSW in Section 1.2.



# Financing and funding

As a for profit corporation, the long-term operating model sees TAHE empowered to act independently in respect of its revenue, cost and financing decisions.

Reflecting that TAHE's current customers are principally the two public rail operators, plus a small proportion of third-party access seekers, Figure 2 below shows TAHE's substantial reliance on revenues that originate from the NSW budget.



Alongside the access charges, TAHE's other major source of revenue will be derived from unregulated licence fees for its unregulated operational assets. Noting the requirement for TAHE to charge economically significant prices, we have used the same building block model used for access charges, applying an unregulated WACC.

Again, for context, the public operators will now show an increase cost representing access fees paid and payable:

Public operator access fee floor (minimum) price: \$1.41 billion

Public operator access fee ceiling (maximum) price: \$4.34 billion

Similarly, there is increase in cost to operators for licence fees, however there is no floor or ceiling mechanism for these charges. Accordingly, KPMG have assumed TAHE will be able to negotiate licence fees for its unregulated assets that are able to satisfy its unregulated WACC – which was assumed to be 7.2% to 7.7%. KPMG WACC modelling is based on IPART parameters with a slight risk adjustment.

# Detailed financial modelling and analysis:

In our June 2020 report to Cabinet, we noted the need for detailed modelling and assessment of TAHE's financial performance and impacts over time. Accordingly, we built the detailed 'KPMG TAHE Financial Model' which includes new capability to show:

- · The quantum of required access and licence fees;
- The calculation of Full Economic Cost to understand compliance with price bounds;
- · A preliminary basis for revaluation on an income approach; and
- Financial impacts on the NSW Budget, TAHE and TfNSW.

Our model has been subject to rigorous internal validation and has also been exposed to external detailed review by TfNSW, NSW Treasury and TAHE officials. For further detail on the inputs, assumptions and function of the model, see **Section 2**.



# Can TAHE put transport customers at the centre of everything it does?

The 2011 creation of TfNSW signalled a major change to transport policy in NSW, in recognition of the limitations posed by having individual and independent agencies, each charged with part of the overall transport task.

Prior to TfNSW, the State's transport agencies were fragmented by mode, seeing:

- Heavy rail: RailCorp with Sydney Trains and NSW Trains acting as subsidiaries
- Heavy Rail Infrastructure Delivery: Transport Construction Authority
- Roads: Roads & Traffic Authority
- Buses: State Transit Authority
- Waterways: NSW Maritime
- Ports: Sydney Ports Corporation
- Light rail: Sydney Light Rail
- Ferries: Sydney Ferries Corporation
- Multi-modal integration and Policy: Ministry of Transport

The 2011 creation of TfNSW saw these agencies restructured and reformed to promote a much higher level of focus on customer journeys, over individual agency requirements.

# Putting the customer at the centre of transport:

The 2018 release of the Future Transport 2056 Strategy placed the customer firmly at 'the centre of everything we do'<sup>[1]</sup>, including being at the heart of transport services and infrastructure planning and investment decisions. This pivot from mode to customer focussed transport was driven by a broader shift from the NSW Government, with Premier Gladys Berejiklian confirming "if we are serious that the citizen, or the customer, is at the heart of everything we do, we need to make the customer our central focus across every single part of government, no matter where they live, or what their circumstances might be'<sup>[2]</sup>.

A set of measurable (via TfNSW's Customer Satisfaction Index) outcomes of the strategy were determined, and include:

- Timeliness
- Safety and security
- Ticketing
- Convenience
- · Ease of connection to other modes
- Accessibility
- Comfort

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- Cleanliness
- Information
- Customer service

## TfNSW's customer-centred program of change:

Evolving Transport is TfNSW's transformation program that will position them to deliver even better outcomes for customers and communities across the State, now and into the future. It is fundamental in ensuring the delivery of the 10 Year Blueprint and Future Transport 2056 vision and is a core change area aligned to delivering on State Outcomes.

Evolving Transport is about:

- achieving more integration and collaborative thinking about transport
- being transport-mode agnostic and managing the transport network holistically
- implementing more efficient and effective ways of working
- creating an operating model that places customers and communities at the centre of planning, design and delivery

Connecting customers whole lives is one of three Transport priority areas of focus. Providing end to end journey solutions is key to managing the network holistically. Transforming the customer experience through excellent service every day, use of technology and data to build deeper insights about customers' journeys, needs and expectations is at the core of the "Customer at the Centre".

#### Who are TAHE's customers?

TAHE's customers are the two public rail operators and a range of other, third party rail operators.

#### Is TAHE incentivised to place the end user at the centre of its decisions?

The public rail operators will provide TAHE with circa 90 per cent of its revenues from network access charges and asset licence fees.

This sees TAHE with little or no commercial signal to fund customer innovations and may result in tradeoffs against the different objectives of both TAHE and TfNSW in final decisions made. The specific objective of TfNSW regarding customer satisfaction and reliability of services provided may have to be tested against TAHE's interest in deriving commercial returns from its rail and property assets. Possible risks include:

- TAHE's single mode focus is inconsistent with the customer outcomes articulated in Future Transport and Evolving Transport strategies;
- TAHE's Board may be unwilling to support investments that may benefit customer convenience, but not provide a targeted commercial outcome, or if supported may expose TAHE to commercial risk; and
- Information provision, including wayfinding remain the domain of TfNSW and the operators. However, to the extent possible TAHE may seek to monetise information data.

# Scope of the long-term operating model

As the scope of the long-term operating model is defined and agreed, it is useful to understand what TAHE does not do in order to ensure activities in relation to other actors remain clear. A list of key activities which are beyond the scope of TAHE is provided in Table 4:

Table 4: Out of scope activities of the TAHE long-term operating model

Function	TAHE does not				
Access and licence arrangements for rail assets	<ul> <li>Operate rail services;</li> <li>Have a direct interaction with rail customers;</li> <li>Determine issues of broader Transport policy;</li> <li>Develop, monitor and enforce compliance with access agreements;</li> <li>Manage the SWTT and DWTT; and</li> <li>Appoint the network controller.</li> </ul>				
Operational and non-operational capital projects	<ul> <li>Have accountability for multi-modal prioritisation of NSW Transport strategic initiatives and investment portfolio; and</li> <li>Have accountability for procurement and delivery for operational capital projects.</li> </ul>				
Maintenance	<ul> <li>Directly (Ieliver maintenance services, undertake asset assurance and set asset standards;</li> <li>Directly set the TAHE SASP (outcomes-based criteria for management), TAHE ASP (plan and high-level policy) and TAHE AMP (requirements to manage costs, risks and performance to meet service outcomes) for TAHE assets; and</li> <li>Determine the level of maintenance expenditure of maintenance funding.</li> </ul>				
Finance and funding	Set the level of equity, CSO subsidy.				



# TAHE is different to RailCorp

Active TAHE is materially different to dormant RailCorp, for a range of factors including:

- TAHE is a statutory state-owned corporation.
- TAHE has statutory financial reporting requirements.
- TAHE's board of directors are bound to act independently in the best interests of the corporation.
- TAHE's directors must make decisions that maximise TAHE's net worth, have a duty to prevent
  insolvent trading and can only engage in non-commercial activities at the direction of the Minister.

 As a SOC, TAHE can be instructed by its shareholding ministers to undertake an activity, but this must be laid before parliament with the corporation reimbursed total net costs.

Unlike the passive RailCorp:

- TAHE makes all final approvals, pending any Cabinet decision, for new rolling stock, track, stations
  and other operating capital projects.
- TAHE controls all funding and investment decisions for commuter car parks, ISDs and other nonoperating capital projects.
- All TAHE projects must have the prospect of a commercial rate of return, or alternatively be appropriately compensated by Government
- TAHE endorses the level of maintenance expenditure on all NSW rail assets both operational and non-operational.

TAHE is different to RailCorp, precisely because it has become a functioning independent corporation, led by independent directors with requirements to act in the best interests of the corporation; within a rail transport sector that is inherently unprofitable.

The corporatisation of state enterprises provides a powerful mechanism to drive independence, transparency and a commercial focus; but it also creates limitations that do not exist on the general government or not-for-profit sectors. The proposed long-term operating model crystallises the access and licence fee arrangements on the NSW budget over the forward estimates.

# Scenarios

In collaboration with stakeholders, a range of scenarios have been developed for financial modelling purposes – this includes input from NSW Treasury, TAHE, Transport for NSW and KPMG.

NSW Treasury's preferred TAHE scenario has evolved, and there are limited but important areas of divergence with KPMG's preferred assumptions.

Noting the areas of divergence are few, but material to the results, we have chosen to model each – portrayed as Scenario 1: KPMG preferred assumptions and Scenario 2: NSW Treasury preferred assumptions.

For a detailed discussion of these issues see Section 2.

The key reason for the large revision in estimated fiscal benefit reflects the inclusion of the substantial operator subsidies – which were not included in the June Cabinet Submission; as well as the inclusion of the correct (and much higher) depreciation costs for the corporation.

KPMG has applied generous (but appropriate) modelling assumptions to TAHE, seeking to improve the net result. Our beneficial assumptions include:

- We hold TAHE's financial return at circa 2 per cent per annum, some 3-5 per cent lower than comparable SOCs;
- We consider 2 per cent to be modest given the long-term government bond rate is circa 1.3%. A return
  marginally in excess of the government bond rate only modestly commences the commerciality
  proposition;
- · We have delayed the switch on in revenue by a year and applied a slow ramp up in revenue/profitability;

- We have assumed that TAHE's access prices can breach the IPART floor; and
- · We have not included TAHE's additional costs for services performed by TfNSW on its behalf.

Even with these beneficial assumptions, TAHE's net fiscal benefit reduces by more than \$7bn over the four-year forward estimates, in comparison to estimates provided to Cabinet in June 2020.

Subsequently, NSW Treasury have requested that KPMG assume:

- TAHE's ROE is calculated based on contributed equity (circa \$10.8bn to FY21), rather than TAHE's net assets of almost \$40bn<sup>3</sup>; and
- The ramp up in revenue for TAHE is pushed beyond FY24<sup>4</sup>.

KPMG has elected to model these beneficial assumptions; but have applied these as the 'Treasury scenario'; reflecting:

- . KPMG has been unable to find any comparators using Treasury's new ROE calculation; and
- We are concerned that further delays in access pricing and revenue switch on will imperil the overall bona fides of TAHE, including meeting classification requirements as a Public Non-Financial Corporation.

KPMG also notes that at the request of NSW Government stakeholders, we have presented a single TAHE scenario and have not provided sensitivities based on likely variables.

# Why a different ROE denominator?

KPMG has opted not to adopt Treasury's preferred denominator to calculate ROE which has resulted in two different views on the correct denominator to include in the ROE calculation, being:

- \$10.8bn capital invested in TAHE since 2015 as at FY21 Treasury's preferred view
- \$37.9bn Total Equity of TAHE as at FY21 KPMG's adopted assumption

KPMG's adopted assumption is based on its application and understanding of relevant Corporate Finance theory, review of Statement of Corporate Intents and Annual Reports of other SOCs in NSW, the NSW Government's undertakings to the ABS and the TAHE Board's responsibility to monitor and report on the performance of its entire portfolio; not only investments since 2015. Further detail on this is reflected in **Section 2**.

Noting the complicated outlook for transport revenue and property demand under COVID19 and the small but material diversion in KPMG and NSW Treasury assumptions, both the KPMG and NSW Treasury scenarios may require further adjustment.

<sup>&</sup>lt;sup>3</sup> Written comments received from NSWT on 28/09/2020.

<sup>&</sup>lt;sup>4</sup> Communicated to KPMG via phone call from Anne Hayes on 14/10/2020.

We have outlined the differences in assumptions in Table 5 below.

Table 5: Differences in the assumptions pervised the KPMG and NSW Treasury preferred scenarios

Assumption	Scenario 1: KPMG preferred assumptions	Scenario 2 NSW Treasury preferred assumptions		
ROE Profile	1-3% from FY23 to FY27, 4% onwards	Expected return set at 1.31% starting in FY23 (10-year sovereign bond rate)		
Denominator to calculate ROE	Net assets (\$37.9bn as at FY21)	Contributed equity from 2015 (\$10.8bn as at FY21)		
Are the rail operators achieving a nil balance?	Yes	No-sustained deficit		

# Detailed modelling results

There will be a range of financial outcomes from the long-term establishment of TAHE which will be affirmed once arrangements such as access and licence fees are agreed. Below provides a summary of the net fiscal impacts to TAHE across the two scenarios with the delta to the June Cabinet submission.

Importantly, the detailed model shows a significant erosion in the estimated net fiscal benefits offered by TAHE over the forward estimates and the 10-year evaluation period.

Table 6: Estimated net fiscal impacts to TAHE

	FY21 (Budget Year)	Forward Estimates (4 year)	10 Year Estimate
Treasury estimate in June Cabinet Submission	+\$1.83bn	+\$7.39bn	N/A
Detailed model - KPMG scenario	+\$1.2bn	-\$0.2bn	-\$5.3bn
Change – June Treasury vs. KPMG model	-\$0.6bn	-\$7.2bn	N/A
Detailed model – Treasury scenario	+\$1.5bn	+\$4.3bn	+4.7bn
Change – June Treasury vs. Treasury preferred scenario	-\$0.3bn	-\$3.1bn	N/A

The KPMG model over the 10 years indicates a net cost of \$5.3bn. This compares to NSW Treasury scenario assumptions reflecting a 10-year benefit of \$4.7bn, noting that from FY24-25 onwards – once full access fees are implemented – TAHE will offer on average circa \$60m pa benefit compared to TAHE in GGS. These assumptions do not consider any broader commercialisation strategy that TAHE may propose.

## Sensitive: NSW Cabinet

service operators

# Assessment against priorities

The TAHE long-term operating model was assessed against Cabinet objectives to determine the extent to which TAHE can be successfully implemented. The ratings are displayed in Table 7 below. For a detailed discussion of these issues see **Section 4**.

Rating **Fiscal objectives** Meet accounting standard requirements by 1 July 2020 Sustain the accounting treatment over time Maintain PNFC classification from the ABS (for-profit TAHE, NFP for ST and NSWT) **Organisational objectives** Rating Supports 'Evolving Transport' and long-term operating model Improves management of assets, commerciality and transparency of the use of public funds Facilitate the integration of networks, services and project planning, across modes and with a customer focus Allow future reform to rail service delivery models Account for TAHE Board's duties and corporate objectives **Operational objectives** Rating Maintain and enhance safe network operations

**Key:** Green = likely to meet the objective, Amber = potential to not meet the objective, Red = highly unlikely to meet the objective.

Create clear, logical operational accountabilities between TAHE, TfNSW and rail

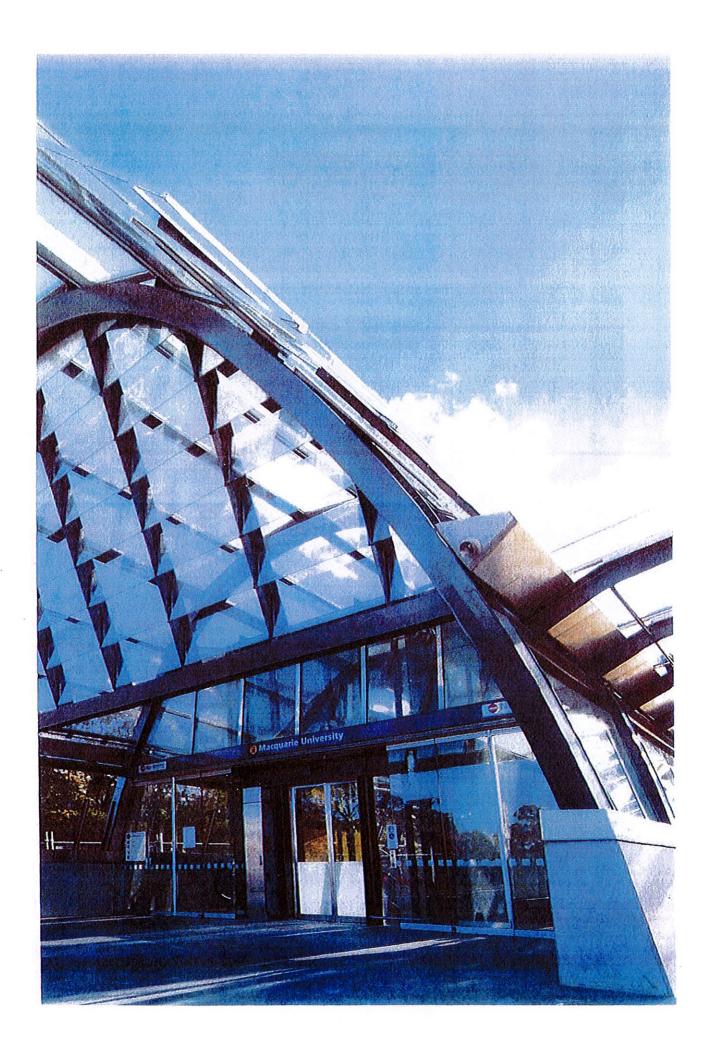
# Next steps

TAHE's creation marks a material change in the shape of transport administration in NSW – and will see the most substantial reordering of functions in rail, since the structural reforms in the 1990s.

The complexity of operation and the overlays of economic, safety, environmental, fiscal and corporate requirements mean TAHE will require a staged transition of duties, over time.

We have outlined a draft transition plan, designed to allow TAHE to focus on establishing its core contractual and commercial relations, found in **Section 3**.





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# Section 1: Longterm operating model

- Concept of operations
  - Access and licence arrangements for rail assets
  - Capital projects
  - Maintenance
  - Finance and Funding
- · Safety considerations



# Section 1.1: Concept of operations



# TAHE: from concept to corporation

RailCorp was converted to a SOC and renamed TAHE on 1 July 2020 assuming ownership of all NSW railway assets. TAHE is governed by an inaugural board of directors; and led by acting chief executive and key management personnel who are managing the corporation's affairs, in the transition to its long-term operating model.

TAHE is a commercial, for profit corporation, with an imperative to drive a commercial return from the use and development of its assets.

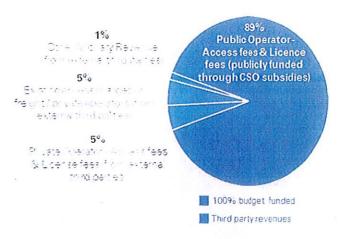
As a rail infrastructure owner, TAHE operates in a highly regulated sector. There are a range of statutory overlays that dictate what TAHE can do; how much it can charge; and when and how its assets are used.

The TAA means TAHE requires an enabling operating licence from the Minister for Transport and Roads (Portfolio Minister) for each of, its functions. Accordingly, the long-term operating model assumes that such a licence is granted to enable each function and power described throughout this report.

TAHE's proposed revenue is materially sourced from the public rail operators – who are in turn funded via subsidies in the NSW budget; with only a very small portion of revenue provided by third party private rail operators – largely in the freight rail sector.

The relative scale of revenue by source is shown in Figure 3 below.

Figure 3: TAHE Total Revenue - Forward Years



TAHE contemplates a substantial role in driving commercial opportunities via its non-operating land assets; for example, through Integrated Station Developments. TAHE, in agreement with the voting shareholders, will determine the commercial returns and metrics, via the SCI.

TAHE remains focused on developing these concepts but is unable to provide guidance on robust assumptions of assumed returns, or time periods over which they may be realised. Accordingly, these are not factored into the financial analysis; but are contemplated in the operating model.

# TAHE's organisational structure

Post 30 June 2020, TAHE has a small acting team in place, comprising of senior executives who are working with the board and TfNSW to define the next steps in the evolution in the TAHE organisation.

TAHE is focused on the future organisational structure and FTE footprint required based on the long-term operating model. The board and senior team will determine the transition plan and next phases depending on the outcomes of recommendations made in this report and cabinet process.

# TAHE within the transport ecosystem

TAHE's long-term operating model sees it become an important and independent actor within a complex, multi-modal transport 'ecosystem'. As noted in the sections which follow, this creates a range of interfaces impacting who, how, when and why decisions are made about rail infrastructure – and the way the costs are paid and recorded. Figure 4 below outlines TAHE within the broader heavy rail transport ecosystem.

Figure 4: Where TAHE sits in the transport ecosystem

TAHE-owned heavy rail assets					
Policy	Promoport for NSW	TFLO I described who salthan opens described by the seasy of methods of contract of the seasy of			
Ownership	TAHE	TAHEOUS of and arrespinos an argements following exements for each soft trained in a a composition of the mass of a composition area and regional fig. (			
Capital projects: Operational	TAHE Transport of NSW	Till Bid etdountakue mi pepidoninia lingit i pupitoutid lohedo kade Gevelyd heim odd vinemapo his pregs epiku Telliu i Telliu his investitetim tali engiser koeneduremento Addountaklin indi dota veri tendigelve i potovim Tilliu i engisu, vinev Teiro			
Capital projects: Non-operational	TAHE NSW Thruston 1	TemBio especialité fil enormeno seculionaria até, vius lab respondiched sistembelli decignatebra livoire, Treins and Thiliúil, fis expinolade of an econ entan denegalato rei capital projesto.			
Maintenance	TAHE	THE Denselop out Hosethod wance Frame non its outpoints the Edelon in remark into outpoints outp			
Finance & funding	NSW STATES	THIRE independent control over the level and termic of its revenues dicense and acceptified with the green level of debt, and the published of Government funding. The level of Government funding use equivirige store, outsitives and greens of Wildernstell, be sater mined by 100 mGovernment.			
Asset pricing & commercialisation	TAHE	THE map unlateral control one the lavel and termiologic or energy little one and appears fearly outgetter to a full on PAU and IPAPTs floor-ceiling requirements for regulated appears.			
Access contract management	NSW Transport for NSW	Trivisivi, aprovad TAIIB oragant knone man aga ma to a ron agotvarion of contractor in its Apparoulical and Trivisi, also pass adoptimos vaga main toarba ob amb pasammant tha faivel anoma toano visi had ter woard publicabothough ting Standard Visio Wag Tamasatia - OkitTAII in its TAIIB negotiating on prote			
Network Controller	Assistant Hot	Guare. Trended the Place on Commission of the VP your Seldone Hoteland Head of the Strategy of the Commission of the Strategy of the Dealy Trended and Cheby Trended and Cheby Trended of the Strategy of the Dealy Trended and Cheby Trended of the Strategy of the Dealy Trended of the Strategy of			
Passenger services	1	Facce right set likes are plouided by the public real operators – Dirately Traincland Authorisms 1.5. Thans – on the 1.51 and CRI (prospectively.			
Private Third Party Access Seekers	Third Party Access seeker				

# TAHE's balance sneet 8 cash flow

TAHE owns all the heavy rail rolling stock, track, infrastructure, land and property, plant and equipment held by the former RailCorp on 30 June 2020.

TAHE's balance sheet comprises \$39.9 billion of fixed assets and \$2.5 billion of interest-bearing liabilities from TCorp. Currently, TAHE has minimal cash flows, reflecting \$60 million in access fees presently paid by private third-party access seekers to the rail network.

Table 8 below provides an overview of the value of TAHE's assets and liabilities as of 1 July 2020.

Table 8: Overview of TAHE's balance sheet

# **TAHE Balance Sheet (Net Asset Value)**











Rail infrastructure (including track) \$9.6 billion

Land and Earthworks \$11.1 billion

Electrified Network \$3.1 billion

Rail Signalling Systems \$2.0 billion

Network Control \$0.5 billion

Subtotal - Regulated assets









\$26.3 billion

\$13.6 billion

Stations & Facilities \$10.1 billion

Rolling Stock \$2.7 billion Depots & Yards \$0.5 billion Property Portfolio \$0.3 billion

Subtotal - Non-regulated assets



Cash and other current assets

\$0.1 billion

# **Total assets**

\$40.0 billion







Interest bearing liabilities – T Corp \$2.5 billion

Other current and non-current liabilities \$0.5 billion

Total liabilities	\$3.0 billion
Net Assets	\$37.0 billion
Total Equity	\$37.0 billion

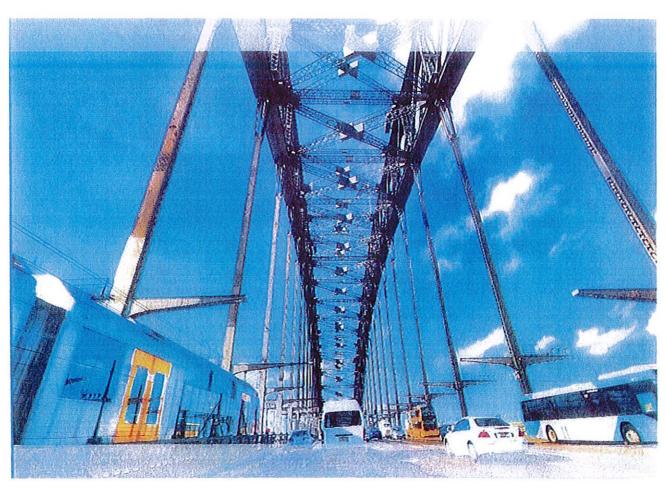
Source: May 2020 PRIME

# Summary of relevant legislation, regulation and policies

Aside from safety and environmental laws dealt with through the separate safety advice, there are a range of acts, regulations and policies that impact how TAHE may act. Table 9 below provides a summary of the key legislative instruments.

Key legislative instruments	Summary
Transport Administration Act 1988 (TAA)	The TAA Act created TAHE, conferring specific functions and setting out objectives that it must meet.
State Owned Corporations Act 1989 (SOC Act)	The SOC Act sets out requirements that TAHE must meet such as delivering a Statement of Corporate Intent.
The NSW Rail Access Undertaking	The NSVV Rail Access Undertaking sets pricing requirements and principles for Rail Infrastructure Owners that must be consistent with the floor and ceiling test while also complying with the IPART review process.

See Appendix 3 for a detailed assessment of TAHE's legislative and regulatory environment.



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# An overview of TAHE provided by the TAHE Executive team

The following excerpt was provided to KPMG by the TAHE executive team on the 10<sup>th</sup> October 2020 and provides an overview of TAHE.



#### 1.1. TAHE Reform Objectives

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#### 1.2. TAHE in the context of the Transport System

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#### 1.4. TAHE's Alizament to Government Priorities

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#### State Outcomes TAHE Alignment to State Outcomes

# Outcome 1 - Accessible Transport

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#### State Outcomes TAHE Alignment to State Outcomes

# 1.5 Benefits of the Corporate Structure

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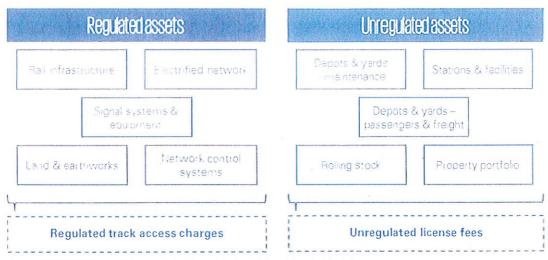


# Section 1.1.1: Access and licence arrangements for rail assets

Over any reasonable evaluation period, TAHE's major source of income is likely to remain its regulated access charges and unregulated licence fees levied from public rail operators; with currently only a small portion of revenue drawn from private rail operators and TAHE's commercial activities.

Figure 5 below provides a segmentation between TAHE's regulated and unregulated assets.

Figure 5: TAHE-owned regulated vs unregulated assets



Source: KPMG 2017 Access Pricing and Cost Model, Sydney Trains

Noting that no access or licence fees have been charged to public rail operators in NSW for almost two decades, the commencement of access fees from FY21-22 will mark a substantial change in financial arrangements for public passenger rail operations in NSW.

Figure 6 below presents a simplified process outlining proposed accountabilities under the TAHE long-term operating concept.

Statement of Corporate Intent Operating Licence TAHE • \$ 1760 = 1806 40 earns 18 Freight and other • 14.4000 eponates Access 49 earlierts private operators • Sets proing policies • Sens 30/77 Batas a les A3A contro docale mon tora compliance. a no strat<del>a</del> gy • Non tors & enforces conto la roe Appoints agents. • Establishes Coerating Protocolis with 1 study. Comid a • Negociates proling-with Public Operators Reports to TAHE & IDART Maintainado logi funció glos enticilidades. Assurance function NSW TrainLink • Develop da vitra no an • Mairage & administer agreement • Incident management • Provides vard waragement services ・ info mation to TRUSCA を TAHE! TAHE negociates and ng with Public Oberators

# Accountabilities for regulated TAHE assets

Table 10 below shows the segmentation of accountabilities for access arrangements to regulated assets. This contemplates TAHE with full economic independence and control over access pricing arrangements; while recognising the TAA's grant of power over the Standard Working Time Table <sup>5</sup> and Daily Working Time Table <sup>6</sup>, to TfNSW and the Minister for Transport respectively.

Table 10 Repulated Assets RAC

Function	Function Definitions	Minister	TAHE	TINSW	Sydney Trains	NSW Trains
Track access arra	angements: Negotiating and app	roving track	access ag	reements		
Policy, strategy	TAHE sets policy and strategy for track access pricing, within regulatory bounds		A/R	I	1	I
Standard Working Timetable (SWTT)	TfNSW sets SWTT, daily service periods, type and size of carrying capacity of rollingstock to be an input in access agreements.		C	A/R	C	C
Negotiate access arrangements	TAHE negotiates access terms and pricing for agreement in line with its policy and rail access undertaking.		A/R	R	C	C
Access pricing compliance, review and monitoring	Reporting, compliance, review and monitoring activities to ensure access pricing arrangements are adhered to.		A/R	I	R	R
Regulatory compliance and reporting	TAHE is responsible for ensuring compliance, and collating track access information to inform regulatory agencies.		. A/R		R	R
Appoints network controller	Designated by the Minister of Transport.	Α	1	R		gydd ag y cho Anthr Gall Carlo
Daily Working Timetable (DWTT)	Network Controller manages the DWTT informed by the SWTT, and reports to TAHE and TfNSW.		ı	C	A/R	

<sup>&</sup>lt;sup>5</sup> Clause 5(1), Schedule 1, TAA 1988 (NSW).

<sup>&</sup>lt;sup>6</sup> Section 99D (1)(a), TAA 1988 (NSW).

#### Sensitive: NSW Cabinet

Access pricing policy, service planning and network operation

The long-term operating model contemplates TAHE with unilateral control over access pricing strategy and policy, within the bounds created by IPART's ceiling and floor determination. But recognising the intention and effect of the TAA, sees TfNSW determine the level and frequency of rail services provided through the Standard Working Timetable; and sees TAHE play no part in the practical management of train access and separation – a function of the Network Controller.

Access fees with public rail operators for regulated assets are yet to be determined, whilst access fees with private operators are already being charged. From FY21-22, it is anticipated that the regulated access fees will be within the IPART ceiling and floor and will require new charges to be set for both public and private operators accordingly. However, in FY20-21 the Financial Model indicates TAHE is in breach of the NSW RAU with access prices, implicitly made of maintenance costs incurred by Sydney Trains, below the floor price.

For the purposes of financial modelling a number of scenarios have been presented, all which consider access fee charges to occur from FY21-22. These include public operators being charged \$700m pa from FY21-22, and comprising a significant component of TAHE's total revenue thereafter.

Access pricing arrangements between TAHE and the operators are yet to be determined and will be informed by TAHE's access pricing strategy, and guided by its overarching Corporate Strategy and Statement of Corporate Intent (SCI).

This will provide the NSW Government with an opportunity to influence TAHE's overall direction and approach on pricing, noting the required consultation between TAHE and the Portfolio Minister required under sections 20N (notice of non-commercial activities), 20O (notice of public sector policies) and 20P (direction in the public interest), of the SOC Act. <sup>7</sup>

Section 14 of the TAA also contemplates the portfolio minister's grant of operating licences as providing a mechanism for coordination on access to and licensing of, TAHE's assets.

We have estimated the current IPART floor and ceiling prices for the TAHE rail network to be \$1.4 billion and \$4.3 billion respectively in FY20-21; noting that these prices include maintenance costs. These are calculated estimates and indicative only and will be subject to IPART assessment.

Under clause 5(1) of Schedule 1 of the TAA; TfNSW is granted responsibility for the determination of the Standard Working Time Table. <sup>8</sup> This sees TfNSW determine the choice of which services are provided and when; but noting the function of IPART's price regulation function, it is assumed that additional capital or operating costs to TAHE will be recovered through the access charges levied on public and other operators.

Section 99D(5)(a) of the TAA governs the priority of passenger over freight services, providing that "a body responsible for network control must give reasonable priority to rail passenger services". 9

Section 99D(2) of the TAA provides for the Minister for Transport & Roads to appoint the 'Network Controller'. <sup>10</sup> As per section 99D(1) of the TAA, this statutory role controls the service planning (namely, the timetabling of rolling stock), and real time control (namely, the actual control of the movement of rolling stock). <sup>11</sup> This function is allocated to Sydney Trains as the operator of the MRN; and the appointment to the suburban network operator and Rail Infrastructure Manager is considered unlikely to change; noting safety requirements and prior experiences.

<sup>&</sup>lt;sup>7</sup> Sections 20N, 20O and 20P, SOC Act 1989 (NSW).

<sup>&</sup>lt;sup>6</sup> Clause 5(1), Schedule 1, TAA 1988 (NSW).

Section 99D(5)(a), TAA 1988 (NSW).
 Section 99D (2), TAA 1988 (NSW).

<sup>11</sup> Section 99D (1), TAA 1988 (NSW).



# About: NSW Rail Access Undertaking & IPART compliance

- Rail access regimes were implemented as part of the National Competition Policy (Hilmer) reforms to the operation of Australia's freight and passenger railways.
- RAU's are designed to curb natural monopoly powers available to rail infrastructure owners and seek to ensure efficient costs.
- The NSW Rail Access Regime was first established in August 1996 and updated by a new NSW Rail Access Undertaking in place since 1999 12.
- The NSWRAU blends negotiate/arbitrate and direct price control approaches; and applies to TAHE's rail network.
- The floor-ceiling approach within the NSW Rail Undertaking reflects the bounds of pricing which would
  exist if the market was open to competition, providing an economically defensible method of
  regulation.
- The ceiling is based on stand-alone costs and aims to prevent the regulated access provider from extracting monopoly profits.
- The floor is based on 'avoidable costs' and aims to ensure that prices are not set so low that some rail
  operators do not pay for the costs of the services they use.
- IPART undertakes an annual compliance review to ensure that the Rail Infrastructure Owner has
  complied with the ceiling test.
- While the RAU has been in place since 1999, as at 1 July 2020, RailCorp assets are now operating
  under very different legal, regulatory and structural obligations. Prima facie, it appears that the NSW
  public rail operators became third party rail operators as at 1 July 2020 meaning that at least the floor
  price should have been imposed from that time.
- Presently, the TAHE long-term operating model contemplates access fees switching on from 1 July 2021, which is implicitly only to the extent that maintenance and maintenance oncost is funded by the Operators – and below IPART's minimum rate.
- Appropriate legal and regulatory advice should be sought to determine the impact of the RAU on the assumed cost and timing of the commencement of asset charges.

While in early stages and not endorsed by Cabinet, a proposal exists for the RAU to be reviewed over the coming 12 months, which is expected to see a modernisation and tightening of access and pricing regulation to ensure compliance with the national access regime. <sup>13</sup>

# Negotiating access agreements

The long-term operating model contemplates TAHE leading commercial negotiations with the public rail operators, to demonstrate TAHE's independence. Though, it is noted that public rail operators will remain subject to any directions made by TfNSW under section 3G of the TAA, in relation to the exercise of their functions.

TAHE's management has advised an intention to appoint TfNSW to act as its agent in respect of non-government third party access seekers, at least in TAHE's initial period of its long-term operating model.

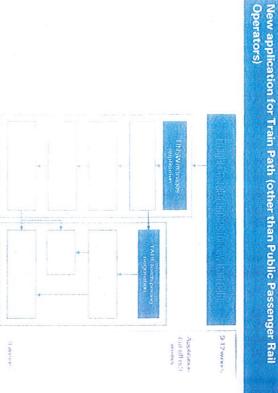
We have provided two alternate process case studies below, outlining the intended process for access negotiations for public rail operators, and for third party access seekers.

<sup>12</sup> https://www.pc.gov.au/\_ciata/assets/pdf\_file/0010/243100/sub019-transport.pdf

<sup>&</sup>lt;sup>13</sup> Source; consultation with CST, regulatory division, 28 September 2020

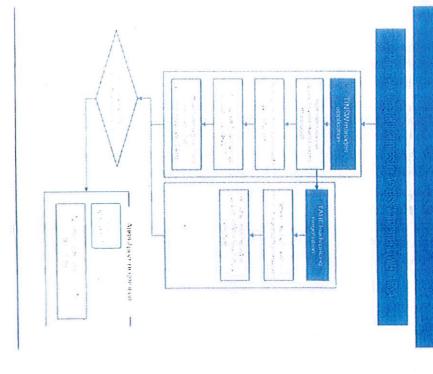


CASE STUDY





Access Agreements with Public Passenger Rail Operators



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The NSW Rail Access Undertaking has been in place since 1999 <sup>14</sup>, establishing the roles and accountabilities between access seekers and TAHE; requiring an access request and allocating accountabilities on TAHE to respond within set time frames, providing required technical and operational information.

The two case studies above seek to apply the intention developed in the RACI, to the requirements created by the NSWRAU.

We have sought to maintain the responsibility for technical aspects of access applications and negotiations with TfNSW, noting the specialist skills located within TfNSW, Sydney Trains and the Greater Sydney and ROM divisions.

While the operating model contemplates TAHE appointing TfNSW as its agent for these technical aspects, we consider that TAHE will require access to relevant information to inform itself adequately for the commercial negotiations with public and other third-party access seekers.

The operating model contemplates TAHE with contro! over commercial negotiations, but these occur within the regulated floor/ceiling determined by IPART. The NSWRAU requires that no access seeker can be charged less than the floor price.

It is contemplated by the operating model that the relevant access arrangements will be reflected in the new Rail Services Contracts, required beyond 1 July 2021 – making access prices a near-term reality for TAHE and for public rail operators in NSW.



# Could access charges be recovered as an annual flag fall charge?

TAHE is logically seeking to limit the complexity of the access pricing arrangements that will be imposed on the public rail operators from 1 July 2021. This has seen the suggestion of a 'flag fall' access charge – a single annual access charge to Sydney Trains and NSW Trains, presumably based on the SWTT.

Under the NSWRAU, access charges are determined using a building block approach that considers the true costs of each segment of the network accessed. This provides a floor and ceiling, between which negotiations between TAHE and access seekers occur; with binding arbitration in the event that commercial agreement cannot be reached.

TAHE's suggestion of a move to a flag-fall charge would reduce the complexity of arrangements for the overwhelming majority of TAHE's revenue – reducing the deadweight costs of returning to publicly funded access pricing on the rail network.

However, the introduction of a flag fall access charge has some predictable detriments, including:

- In the absence of accurate monitoring and reporting to support an annual 'true up adjustment, the flag fall access charge would unlikely provide greater transparency and efficiency to the rail access regime if it is treated as a simple fixed annual charge to the operators.
- The flag fall charge must fall within the IPART floor-ceiling approach in accordance with the NSW Rail Access Undertaking regime, which was established to encourage competition.
- If the flag fall charge is above the ceiling or below the floor, TAHE would be considered in breach of IPART's regulatory approach.

Currently in NSW, access charges are generally levied as a combination of a fixed charge (e.g. a train kilometre charge) and a variable charge (e.g. a gross train kilometre charge); in some instances, charges are fixed in nature only (e.g. charges on the Port Botany Rail Line).

<sup>14</sup> https://www.pc.gov.au/\_\_data/assets/pdf\_file/0010/243100/sub019-transport.pdf

#### Sensitive: NSW Cabinet

The pricing structure is typically designed to reflect the costs faced by below rail owners and managers. The implementation of an 'annual flag fall' may charge based on anticipated track usage means the charge would likely materially depart from the actual costs faced by TAHE.

On this basis, an annual 'true up' adjustment should be made whereby an annual payment adjustment occurs between the Operators, TAHE and TfNSW. The mechanism should be agreed within the tripartite RSA and contemplate payments for over/under utilisation of the track, forced track possessions (e.g. for special events) etc.

Timing of the annual 'true up' adjustment should be aligned with IPART's annual compliance review and ensure that sufficient data is available to demonstrate charges are within the regulatory bounds. It is KPMG's understanding that as you approach 80% of 'full economic' costs threshold, there is a high likelihood that this will trigger an annual review.

# Access pricing assurance and monitoring

The long-term operating model contemplates TAHE having accountability for appropriate controls and measures to ensure that its access pricing agreements and arrangements are enforced and realised.

This is discussed further in the funding and finance section (see Section 1.1.6).

# Regulatory compliance and reporting

Noting that access charges have not been imposed on public access seekers for almost two decades, regulatory activity has still been undertaken with regard to 'third party' access seekers (e.g. freight operators) that are charged for access to the NSW rail network.

With TAHE no longer being a NSW Public Agency and being declared an independent SOC from 1 July 2020, the NSW public rail operators become 'third party' rail operators from the same date – meaning access charges should be charged, at least at the floor price. Presently, compliance reporting is performed by TfNSW through the CST division. It is anticipated that TAHE will appoint TfNSW as its agent in interface with IPART, reflecting the highly specialised skills involved. Nonetheless, TAHE will require access to relevant information to ensure it is an informed asset manager; and that there is a direct connection between corporate funding requirements, market pricing impacts and regulatory considerations.

TAHE's board will need to authorise any regulatory submissions, reflecting that it is the rail infrastructure

# Temporary modifications to the SWTT

While TfNSW determines a complex, whole of network Standard Working Time Table which may operate for several years or even longer, there are a range of predictable factors which see temporary alterations affecting the level, type and frequency of services that will be operated.

Typically, these alterations arise due to special events that require a different operating timetable for that period of time; or track possessions that interrupt normal operations – for example, major track replacement works on a corridor.

Any modifications to the SWTT are advised by the issue of Special Train Notices (STNs) or Tables Telegrams and are accessible to Rail Operators through various electronic means.

The Network Controller notifies Rail Operators of all known Special Events and Track Possessions; and consults and negotiates with Rail Operators on impacts, making reasonable endeavours to resolve issues subject to:

- · the requirements of Reasonable Passenger Priority;
- the availability of capacity on the Network;
- the reliability of the Network;
- the bona fide requirements of other users and prospective users of the Network; and
- capacity requirements of both Sydney Trains and NSW Trains.

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The Network Controller coordinates with all parties involved to develop the STNs and minimise the impact of Temporary Modifications to the SWTT on time tabled paths.

Each year, TAHE will authorise the possessions calendar once it is assured that Sydney Trains has attested to complying with TfNSW's asset management standards in development of the planned maintenance schedule, and the financial impacts of non-maintenance track possessions are considered within annual access pricing arrangements.

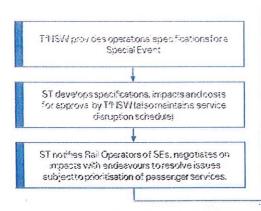
An unresolved issue remains the development of a suitable payment mechanism to take into consideration alternations to the anticipated usage of TAHE's assets, resulting in an over or under charge within the annual access fee. This is likely to be in the form of an annual 'true up' adjustment, informed by adequate performance reporting and monitoring.

While this is likely to prove a minor issue for TAHE; it is nonetheless an interesting reflection of the complexities that accrue through the reintroduction of access charges for public rail operators in NSW.



# Special Event - Sydney Mardi Gras Parade

- A Special Train Notice is issued by the Network Controller.
- Outlines impacts to SWTT and service disruptions.
- E.g. One additional 8 car train will depart Central (ESR) at 2359 hours stopping Redfern. Wolli Creek, Hurstville, Sutherland, Waterfall then all stations to Wollongong.
- TfNSW provides operations specification to ST and approves worked up specifications, costs and impacts by ST.
- TfNSW reimburses STs for all costs incurred above normal operating costs.
- Any unders or overs are anticipated as being reconciled in the annual 'true-up' adjustment.





Thisw & TAHE approves Special Event operational specifications and planned service disruption (in terms of customer disruption)

ST coordinates, manages and delivers Special Event.

Thisw reimburses TAHE for access revenue foregone; and Sydney Trains for changes in normal operating costs.

# incidents & unplanned disruptions

TfNSW and the public rail operators have developed protocols that apply in the event of a safety incident or unplanned interruption. While TAHE remains accountable for imposing safety and asset standards, TAHE are not responsible for immediate safety incident response or action. TfNSW and the relevant operating party are required to report to TAHE on significant safety incidents.

Rail Operators are required to manage all incidents and unplanned disruptions in accordance with the protocols established under its Safety Management System – a requirement under Rail Safety National Law that requires provision and maintenance of an emergency response capability.

TfNSW provides disruption communication management protocols and will provide assistance to Rail Operators in the undertaking of emergency response activities and exercises.

Upon identification of an incident, Rail Operators are required to immediately notify TfNSW and the Network Controller of any significant service disruption.

The Network Controller is required to maintain an Incident Management Framework and manage all incidents and disruptions in accordance with this framework and requirements under Rail National Safety Law.

Short Notice Track Possessions – Urgent or Emergency Track Possessions – are considered by Sydney Trains when finalising the Daily Train Plan or in the Live Programme. Rail Operators are advised by phone if a Short Notice Track Possession will impact on their Train Path in the Live Programme.

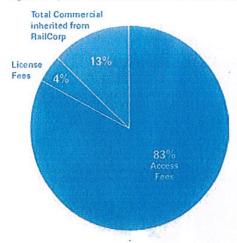
The aim of Sydney Trains is to direct Trains to operate to the Daily Train Plan. However, events on the day may prevent this from happening. When this occurs, alternate directions may be given in accordance with the agreed Operations Protocol, to accommodate real-time delays, re-scheduling and cancellations of Train Movements.

Final decisions in relation to the Daily Train Plan and daily Train Control on the MRN are made by Sydney Trains Train Control.

# Licence Fees on Unregulated Assets

Alongside access fees, the licence fees that TAHE will charge for its unregulated assets can be expected to form a secondary but material source of income for the corporation. As with access charges, these assets have been provided to the rail operators free of charge since the mid-2000s, making accurate price discovery complex.

Figure 7: Split of revenue between licence and access fees



TAHE will charge access or licence fees for unregulated assets.

For simplicity in this report and noting the requirement for TAHE to be a profitable corporation, we have assumed TAHE will be able to negotiate licence fees for its unregulated assets that are able to satisfy its unregulated WACC – which was assumed to be 7.2% to 7.7% <sup>15</sup>.

Noting licence fees will be negotiated over the next 12 months, subject to TAHE management and the TAHE Board decisions and Corporate Strategy.

<sup>15</sup> KPMG WACC modelling based on IPART parameters with slight risk adjustment.



# How do unpriced car parks become 'commercial'?

TAHE's unregulated assets have been provided largely free of charge, generating little revenue and with maintenance costs directly funded by TfNSW. This case study explores the impact as these assets move into a commercial SOC that must charge licence fees to recover its costs, plus a commercial return atop assets with no direct user price.

Since 2011, TfNSW has funded the delivery of >10,000 commuter car spaces across TAHE's network of railway stations. On 1 July 2020, TAHE owned \$498 million worth of car parks, other than limited attribution from Opal ticketing, charges nothing for their use. Many of these car park developments are the result of election commitments.

A further 8,000 spaces are under advanced planning or delivery at stations including Beverly Hills, Casula, Leppington and Edmondson Park, among others. This will see a further capital spend of \$112 million in FY21 – adding a total of \$338 million over the forward estimates.

Already, direct maintenance costs for TAHE's car parks are estimated at \$3 million per year; noting only c.\$300,000 pa is actually budgeted. This figure does not include the additional 8,000 spaces under development – or overheads.

Assuming a closing balance of \$610m of car parks in FY21 and a post-tax real WACC of 7.2 per cent, TAHE's ownership will mean funding a range of costs for commuter car parks, including some \$44m in required returns; twinned with circa \$40m of depreciation costs.

As a for profit corporation, TAHE will require returns that are beyond simple cost recovery; but will need to recover its operating, capital and profit requirements.

It is anticipated that TAHE will charge a licence fee to TfNSW or operators via CSO to cover these costs and generate profit, in the likely absence of a material policy change on passing substantial costs through to users.

While decision making on future car parks will be made considering a raft of objectives, it is anticipated that TAHE will charge a licence fee to TINSW or operators via CSO to cover these costs and generate profit, in the likely absence of a material policy change on passing substantial costs through to users. This new funding arrangement is a key change to current arrangements.



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# Section 1.1.2: Capital projects

As the owner of a complex railway asset portfolio serving a large global city, TAHE's interaction with capital projects will be an obvious and important aspect of the corporation's contribution to transport – and its financial success.

Noting its asset register, TAHE's capita projects will logically span from small, relatively simple projects like small commuter car parks or modest station upgrades; through to complex and expensive integrated station developments – or the procurement of new train fleets.

Additional overlays like the RSNL and the practical reality that TAHE does not engage with ultimate users of its assets and transport network mean it has been useful to segment TAHE's capital projects between two essential groups, Table 11 below describes this further.

Table 11 Definition of TAHE capital projects

# Types of TAHE capital projects

# Operating capital projects



New train procurement, mid-life refurbishment, new and major upgrades of maintenance facilities.

# Rolling stock



New track, upgrades to existing track/stabling.

#### Iraci



Major upgrades to existing stations, passenger information infrastructure, wayfinding.

# **Stations**



New and major upgrades of signal equipment, train control, train signalling interfaces.

# Signalling



Traction

Section hut and sub-stations, catenary and overhead wiring, distribution.

# Types of TAHE capital projects

Non-operating capital projects: Capital projects with no interface to the operational rail services



Include acquisition, ownership, commercialisation, development and disposal but excluding land and property defined as 'railway premises' in the RSNL.



Carparks

Includes future commuter car parks.

# Delivery Agreement and related issues - TAHE and TfNSW

A number of agreements will need to be developed between TAHE and divisions and organisations within the Transport cluster. For example, the I&P division will want to execute a clear Delivery Agreement on the terms of project delivery. The features and types of issues to be contemplated via agreements are listed below:

- TAHE delegating decision making authority to TfNSW (small or recurring projects, or capital programmes);
- Confliction resolution process (who is the ultimate decision maker should disagreement arise);
- Funding project activities (who pays, when and reimbursements);
- Delivery contingency (cost overruns and underruns);
- · Delivery partner selection (how to determine, and under what terms); and
- Contract signing (under what circumstances do TAHE or TfNSW sign contracts for capital projects).

The concept of operations and case studies presented in this section provide direction for a Delivery Agreement. For example, the role of I&P in undertaking procurement of rolling stock, and TAHE being required to authorise any variations in project scope.

However, other issues remain unresolved and a fundamental challenge, such as addressing project cost under and overruns. At present, there is a small amount of P90 portfolio level contingency which is held by TfNSW (most projects are only funded at a P50) Corporate Services and a P50 level of contingency held by 18.D

With uncertainty around which individual projects will encounter overruns a pooling approach to contingency management is applied, as it allows for lower levels of contingency to be held across the portfolio. However, under the TAHE long-term operating model project contingency will need to be split – resulting in TAHE being required to hold a proportionally larger contingency pool for projects with a reduction in TfNSW's ability to 'cross-fertilise' across project modes.



**Operating rail assets** such as trains, track, signalling and stations form the overwhelming majority of TAHE's asset register; meaning that the corporation must have demonstrable control over key choices relating to operating rail assets subject to TAHE complying with the asset standards as stipulated by the operating licence.

However, the operating model considers that through the imposition of access and licence fees, TAHE will generate a revenue stream across its asset base.

# Accountabilities for operational rail projects

Table 12 below shows the segmentation of accountabilities between TAHE and transport agencies, across each stage of an operational rail project. This contemplates TfNSW with the overarching accountability for network-wide prioritisation; but with TAHE granted full accountability for each subsequent stage from initial planning to funding approval.

Table 12: RACI allocations for operational capital projects

Function	Function Definitions	TAHE	TfNsW	Sydney Trains	NSW Trains
Planning & deli	very of capital projects				
Investment prioritisation Transport network	Multimodal prioritisation of NSW Transport strategic initiatives and investment portfolio, including TAHE assets.	C	A/R		
Investment prioritisation TAHE	Prioritisation of TAHE initiatives and investment portfolio.	A N	R		
Prefeasibility funding	Authorises funding for Planning, Investigation & Strategic Business Case for assets to be included in TAHE portfolio.	A**	R		
Gate 0: Need identification	Authorisation of needs identification and planning activity prior to commencing business case (end of initiation process).	A	R	1	1

Function	<b>Function Definitions</b>	TAHE	TfNSW	Sydney Trains	NSW Trains
Planning & delive	ery of capital projects				
Strategic business case	Authorisation of Strategic Business Case for TAHE assets.	Α'	R	C.	C
Final business case	Authorisation of Final Business Case for TAHE assets.	Α	R	С	C
Funding for implementation	Funding approval or release for delivery / implementation for TAHE assets.	Α	R		TO STATE OF THE ST
Procurement	End to end procurement process of approved asset or service.	1 .	A/R	I	I says
Deliver	Delivery of asset or service from detailed design through to testing and acceptance.	C	A	A/R	C
Variations	Approval of funding for variations from FBC.	Α	R (1)	R	100100000000000000000000000000000000000
Asset acceptance	Determines final acceptance of asset.	A***	R***	R	R*

<sup>\*</sup>only Rolling Stock; rail network is with TAHE and TfNSW delivery partner.

The current long-term operating model contemplates TfNSW lead the development of business cases and support each stage of TAHE decision making. This provides for practical alignment on complex, customer and safety-critical decisions and is designed to resolve the gap that exists between TAHE as the rail asset owner and the ultimate customers the assets serve. The current operating licence sees TAHE replicate RailCorp's functions and will need to be updated to reflect TAHE long-term operating model as set out in the Transition Plan.

TAHE is allocated accountability to authorise the gate 0 assessment; where documentation is prepared on its behalf by TfNSW. TAHE's Board and executive delegations then have accountability for authorising each stage of a rail project business case for submission to INSW.

TfNSW must ensure business cases meet service and technical requirements through its own internal governance arrangements – the Finance and Investment Assurance Committee (FIAC), prior to being submitted to TAHE for authorisation. In this way TfNSW retain decision rights to not progress or fund proposals, however TAHE retains ultimate 'sign-off' on business cases for INSW assessment and ERC approval.

# As the owner, TAHE also authorises and remits payments for projects during delivery.

TAHE reduces to 'informed' during the procurement of the asset; is consulted during delivery; is charged with approving any variations in scope or cost; and determines the final acceptance of the resulting asset – with the public rail operators responsible to TAHE for technical aspects of acceptance, and TfNSW accountable for technical acceptance assurance.

<sup>\*\*</sup>funding from TAHE for TAHE assets - becomes un-capitalised expense for TfNSW.

<sup>&</sup>quot;" financial acceptance is determined by TAHE, technical acceptance is determined by TfNSW.

TAHE also has authority to delegate power and decision-making rights to TfNSW or operator/maintainers for specific proposals, such as small scale or recurring projects. This may be achieved in the Delivery Agreement between TAHE and TfNSW, and possibly through the Rail Services Contract.



# **Regional Network - Transport Access Program 3**

The Transport Access Program (TAP) is designed to achieve the policy objective of making railway stations accessible and integrated through station upgrades, interchanges and car parks. One tranche, the Regional Network TAP 3, consists of 13 regional stations access upgrades across the State.

As an example, an individual project proposed under the Regional Network TAP 3 is the Dubbo Station Upgrade, which has the following scope of works proposed:

- Upgrades to paths around the station precinct and a new accessible 'kiss and ride' zone;
- · Upgrades to customer waiting rooms, service areas and accessible toilets; and
- New tactile indicators along the platform, including improvements to lighting and wayfinding.

Regional Network TAP 3 was selected as a case study because:

- The individual projects are assumed to be small-scale however we anticipate that small projects will be aggregated and be required to pass through the gateway process for TAHE authorisation. We don't anticipate TAHE approval of individual, small scale projects.
- · There are very limited commercial opportunities;
- There are options for delivery partner either I&P or ST;
- The projects are generally located in low socioeconomic regions, with low patronage and little growth potential but high social need; and
- The program is funded by TAHE and prioritised by TfNSW at a program level for TAHE assets only.

Legend: Accountability for Flow of decision making Funds

Project Delivery Lifecycle - Transport Access Program

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# **New PPP rolling stock procurement**

The Regional Rail rolling stock PPP was tested through the IIAF – however it was contemplated to have occurred with the existence of a fully operational TAHE that would approve in the investment decision and enter into the contracting relationship direct with the successful respondent.

A PPP rolling stock acquisition was selected because:

- there is a need to reach agreement on PPP model as chosen procurement model, between TAHE and TfNSW. A PPP would have different financial impacts to TAHE compared to traditional procurement approaches – with TAHE holding an interest-bearing liability;
- it is a large and irregular project with operational significance to TAHE;
- there is necessary input from operators on asset life cycle and management;
- there is a need to balance customer and cost considerations; and
- there are complex contractual and financial arrangements.



Legend: Accountability for Flow of decision making Funds

# Project Delivery Lifecycle – new rolling stock PPP

Flow of Funds	ТАНЕ	TWSN	Deliviry Partner I&P	HOM HOM	est a	Governance	Investment Gates	Project Phases	Stages
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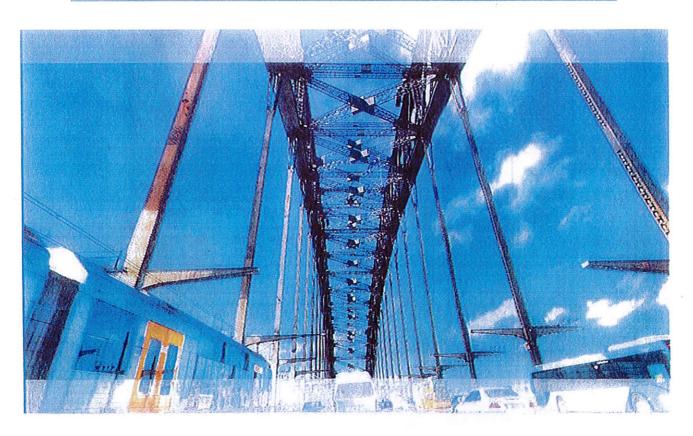
# More Trains, More Services (MTMS) 3

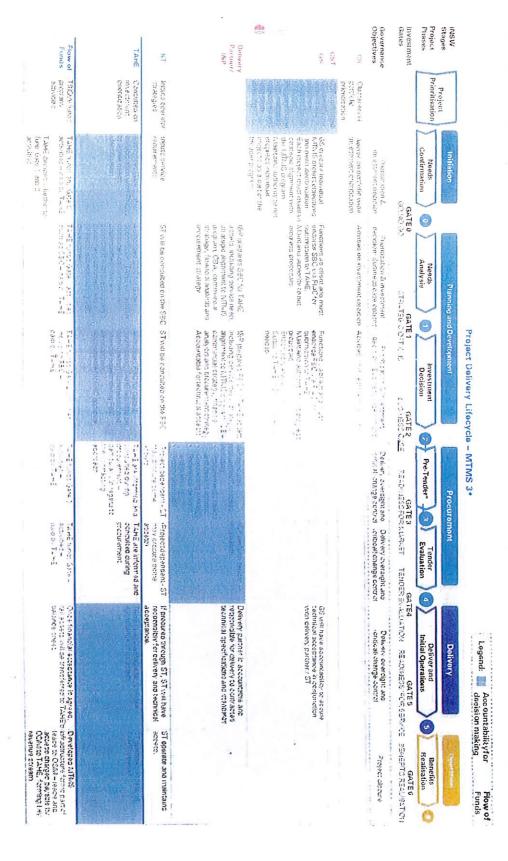
The More Trains More Services programme extends over the next ten years and will roll out technology and upgrades to increase reliability and provide customers with high capacity turn up and go services. MTMS 3 will focus on delivering improvements for the T4 Illawarra, T8 Airport and South and South Coast lines. MTMS components include:

- · Sydney Terminal Area Reconfiguration Project;
- Waterfall Stabling Yard and Platform Extension Project;
- Mascot Substation Project and Access Upgrade Project;
- · South Coast Stations Platform Extension Project; and
- Wolli Creek Substation and T8 Line Power Supply Upgrade.

# MTMS 3 was selected because:

- It is a rail network-wide programme across stabling, track, signalling, technology and stations;
- There is staged delivery, technological complexity and limited potential for new commercial opportunities; and
- There is significance to ST operations with the three lines servicing one third of all Sydney Trains customers.





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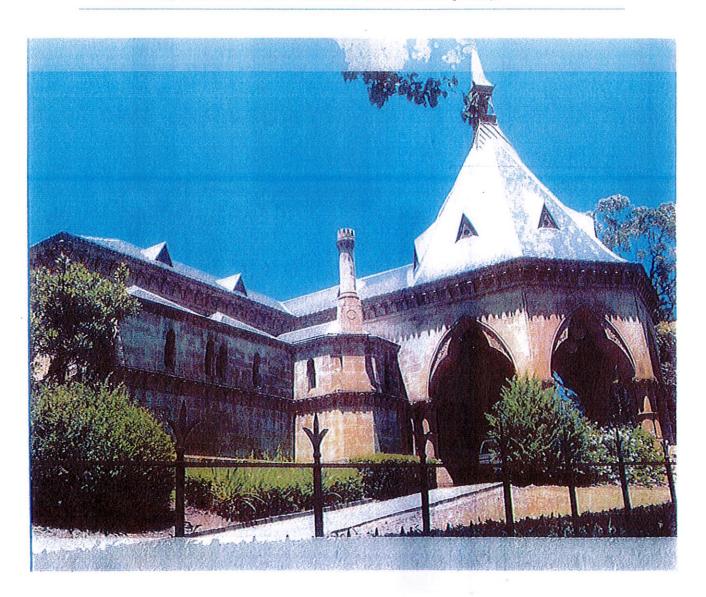


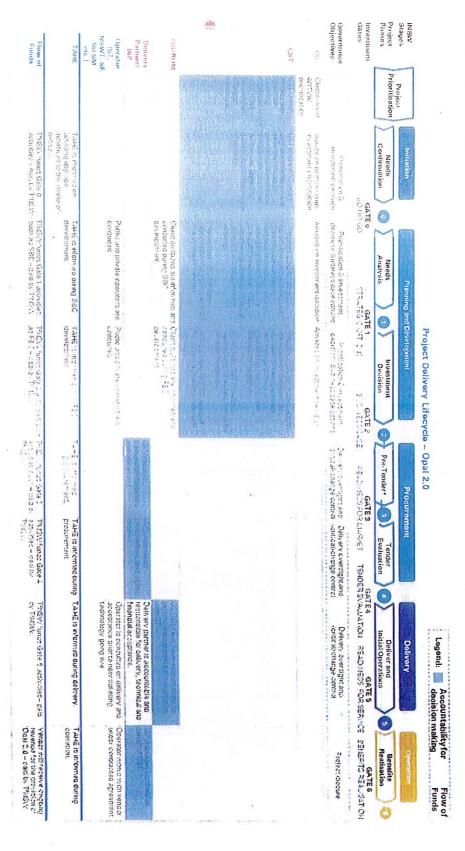
# Ticketing - 'Opal 2.0'

We assumed a new passenger ticketing technology was sought to upgrade the entire transport network ticketing system – requiring new technology, software and equipment. Under this scenario there is an assumption there is no ongoing commercial relationship with any provider.

Ticketing was selected because:

- the technology must be rolled out across all transport modes, not just rail;
- · there are data governance and security issues; and
- there is a very limited role for TAHE who remain 'informed' across gateways.





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Alongside owning and leasing the operating sections and assets of the rail network itself, TAHE also owns \$850 million of 'non-operational' assets; which are largely real estate outside of the paid area and operating rail corridor (noting that parts of the non-operational rail corridor remain governed by the RSNL). These are contemplated by TAHE as a major source of future capital returns and annual revenue for TAHE and form one basis for TAHE's formation.

Typically, non-operational capital projects seek to use TAHE's land assets for:

- · Place making, activation and transport policy outcomes;
- · Commuter car parks (unregulated, but incorporated in the operating licence);
- · Commercial development; and
- · Capital disposal of surplus land.

As an independent, commercial corporation TAHE is contemplated as having unilateral control over its nonoperating commercial developments and other decisions about its investment priorities.

# - Accountabilities for non-operating capital projects

Table 13: RACI allocations for non-operational capital projects

Function	Function Definitions	TAHE	TINSW	Sydney Trains	NSW Trains
Planning & deli	very of capital projects				Property of
Investment prioritisation Transport network	Multimodal prioritisation of NSW Transport strategic initiatives and investment portfolio, including TAHE assets.	C	A/R		
Investment prioritisation TAHE	Prioritisation of TAHE initiatives and investment portfolio.	A/R	R/C		
Prefeasibility funding	Authorises funding for Planning, Investigation & Strategic Business Case for assets to be included in TAHE portfolio.	A/R	R/C		

Function	Function Definitions	TAHE	TÍNSW	Sydney Trains	NSW Trains
Planning & delive	ery of capital projects				
Gate 0: Need identification	Authorisation of needs identification and planning activity prior to commencing business case (end of initiation process).	A/R	R/C	I seems	l
Strategic business case	Authorisation of Strategic Business Case for TAHE assets.	A/R	R/C	C Phillip	c
Final business case	Authorisation of Final Business Case for TAHE assets.	A/R	R/C	C	С
Funding for implementation	Funding approval or release for delivery / implementation for TAHE assets.	A/R	R/C	Andrew States and Andrew State	
Procurement	End to end procurement process of approved asset or service.	A/R	R/C		i i i i i i i i i i i i i i i i i i i
Deliver	Delivery of asset or service from detailed design through to testing and acceptance.	Α	R/C	R	C
Variations	Approval of funding for variations from FBC.	A/R	R/C	C	
Asset acceptance	Determines final acceptance of asset.	A/R	R	<b>1</b>	J*

Prima facie, TAHE's land assets are attractive for development; by definition, they are close to transport and often well trafficked precincts; while by effect, they are usually centrally located within their local community. However, TAHE's land should not be contemplated as an unencumbered real asset, as while 'non-operational', those assets are rarely surplus.

Instead, they might be sought for a range of uses, as noted in the introduction above.

It should also be noted that due to the size of the substantial TAHE property portfolio, the Transport cluster (GG sector) has seen an approved reduction in the TfNSW net property sales target (net of sales proceeds assumed to be returned to the TIP and capital expenditure) from \$2.43 billion to \$613 million, comprised of \$326 million over the forward estimates and \$287 million over the planning years <sup>16</sup>.

As an independent, state owned corporation, the long-term operating model contemplates TAHE with end to end control of each decision related to the utilisation of these non-operational assets.

TAHE has indicated in practice that it would be most likely to seek a role as a project financier; and contemplates potentially appointing TfNSW's specialist I&P division to act as its development partner.

<sup>16</sup> ERC decision, as provided by TfNSW.

Accordingly, the RACI allocates TfNSW as either 'responsible' or as 'consulted' by TAHE on its nonoperational capital projects; depending on whether TfNSW is acting in this role.

As such, we have noted that TfNSW can be either responsible if acting as TAHE's agent; or consulted if TAHE is pursuing a project unilaterally for whatever reason.

Noting the relative paucity of commercial projects, a key issue to be resolved is the division of development returns, if available and realised. The uplift of transport land was originally conceived as a transport activation measure; with a corollary benefit of providing capital funding for transport projects across modes – something that is not possible for TAHE to do.



# Development of a suburban railway station: balancing commercial and non-commercial objectives

One of TAHE's stated outcomes in the second reading speech is a desire for the new corporation to unlock substantial development dividends from across its non-operational land portfolio. But TAHE's land assets cannot be considered unencumbered or 'clean' land; noting that these assets primarily exist to support transport, not commercial, outcomes.

This may see predictable tensions arise, whereby the highest and best use overall, may not provide the highest and best commercial return to TAHE.

Let us assume TAHE owns a well-located parcel of land adjacent to a medium-demand metropolitan railway station, in a designated growth area; with market demand for high density housing in that area; alongside an identified need for community and other facilities – and for 'place making'.

#### Assume that

- TfNSW requires improved activation and accessibility to the station precinct reducing the developable area by 15 per cent;
- TfNSW requires an unpriced bus interchange facility to occupy a further 15 per cent of the site;
- An unpriced commuter car park for 80 cars will see a further 30 per cent reduction in area;
- Complimentary retail development is desired for activation and customer experience, but while providing some revenue, it is not material; and
- After all these requirements, the proposed development has seen the profit margin reduce from 20
  per cent to say, 8 per cent.

Depending on the risk appetite of the Board, this is likely to fall well below the desired IRR for a residential property with residential development. A key question then becomes – 'can the TAHE Board make these trade-offs' – while acquitting their duties to the corporation.

Even if TAHE could become comfortable with these trade-offs, now imagine that:

- The local council is seeking to take commercial space in the development for community services and a library, at a commercial rental rate – but that this reduces the space available for higher return residential strata properties; and
- · This would make the proposal unprofitable.

Some stakeholders have correctly identified that TAHE has five equally weighted objectives that it must meet; but noting that its ability to meet all of its objectives rely on it being financially sustainable and is a going concern. It is hard to understand how TAHE makes the necessary trade-offs in the example above to prioritise other objectives and accept a lower financial return.

These opportunities may well coexist – but TAHE's for profit requirement and the fiduciary duty on its directors mean that TAHE will find these trade-offs difficult to manage in practice.



# KPMG Report - TfNSW Portfolio Review, September 2020

KPMG was engaged by Property NSW, on behalf of Transport for NSW, to assess several sites identified for inclusion in TfNSW's divestment pipeline. As part of the 2019-20 NSW government budget, TfNSW has been allocated a target of \$2.43 billion in asset sales over the FY2019-20 to FY2022-23 period.

Land uses changes over time in response to evolving customer needs and advances in technology. TfNSW has identified some landholdings that may no longer be needed now or in the future, and it is exploring opportunities to better use this land, potentially creating value to reinvest in future transport infrastructure.

TARP has been established by TfNSW to evaluate and prioritise sites that are potentially no longer needed for transport purposes. It involves extensive collaboration across the TfNSW cluster and with other government agencies. This program was established by TfNSW in 2018 as a mechanism to generate additional revenue for the TfNSW cluster in accordance with government direction around asset recycling.

TfNSW has identified 39 sites for divestment, which form the first tranche (Stream 1) of the TARP program. Additionally, TfNSW has also identified 27 sites for a potential second tranche (Stream 2) of the TARP program, with these currently at varying stages of the evaluation and development process.

#### Key observations from the analysis

Of the sites that KPMG assessed, it was determined that asset sales of approximately \$513.6m in net revenue could be achieved in Stream 1 and approximately \$92.8m in Stream 2 within the period FY2020-21 to FY2023-24.

Many sites, in their current state, hold minimal value and hence, where possible, TfNSW should seek to undertake the due diligence and value uplift (e.g. rezoning, subdivision) processes simultaneously in order to expedite the process and realise the uplifted values for TARP as soon as possible.

Some sites present significant complexities, such as those located over rail corridors, and hence further detailed investigations will be required on these sites to determine the feasibility of their divestment.

The complex nature of these sites means that most sites will require detailed due diligence prior to divestment such as environmental studies or assessments of the heritage items that will affect redevelopment.

Several of the sites also have significant transport outcomes associated with delivering a development site that would appeal to the market such as over station developments. This need is to be considered in dotail as it may substantially diminish the potential net revenue associated with a site. As further due diligence and investigations are conducted on these sites, there is a significant risk of additional cost and complexities, particularly when dealing with sites located adjacent to or on the rail corridor. Accordingly, the net revenue forecasts are at significant risk of being diminished further as more due diligence is completed.

Between the 82 Stream 1 and Stream 2 sites that KPMG investigated for divestment; it was determined that asset sales of \$606.4m could be achieved within the period FY2020-21 to FY2023-24. This is a shortfall of \$1.82 billion on the \$2.43 billion target for the FY20-21 to FY2022-23 period.



# Commuter Car Park Program, West Ryde

Planning is underway to provide additional commuter car parking of circa 100 spaces by late 2021 at West Ryde. The proposed development will be funded through the Commuter Car Park Program, which seeks to enhance public transport access at key transport interchanges. The project also included community amenity features such as:

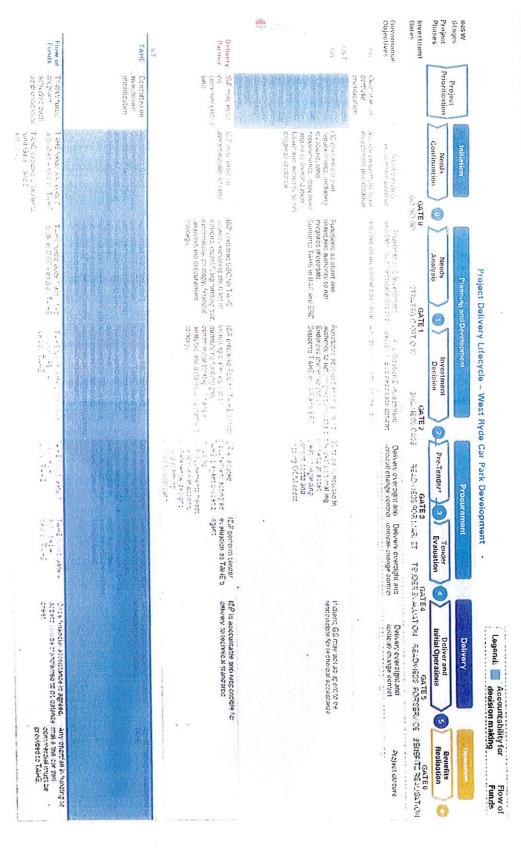
- Landscaping within the car park, including tree planting along the Ryedale Road footpath;
- Provision for future electric vehicle charging spaces; and
- Accessible parking spaces, motorcycle bays and bicycle parking hoops.

The commuter car park was selected because:

- It is an election commitment for a project on TAHE land;
- Car parks are not commercial and require additional budget funding (commuters do not pay for parking, which is free for up to 18 hours under Opal Park and Ride);
- Commuter car parks will ultimately receive capital funding from TAHE;
- · TAHE may seek alternate uses of the land; and
- TAHE is not required to use TfNSW divisions as delivery partner.

This case study assumes there will be no purpose for the car park other than being a car park, i.e. no retail or other commercial uses.





KPMG 39

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# **Theoretical precinct development**

We assumed a theoretical large scale (e.g. \$200m) mixed station and precinct-based development along suburban heavy rail corridor. This includes:

- Existing land-use and zoning which will constrain development potential
- · Major station renewal;
- New public spaces;
- · Community facilities such as library; and
- Residential and commercial property development opportunities.

A precinct development was selected because of:

- The challenge to balance commercial, community and customer benefit in precinct planning;
- The challenge to obtain local council approval for residential or commercial development;
- The challenge to achieve political approval for residential or commercial development;
- 'Place' elements reduce development uplifts; and
- The likelihood to have commercial elements, but they are assumed to be less than costs.

We have applied the Gateway process as an illustrative tool for this case study. This is noting that these types of developments are not traditional infrastructure projects which are handed over to be managed in the traditional way.



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# Section 1.1.5: Maintenance

# Maintenance of TAHE's assets

Maintenance has been among the most complex issues in developing a long-term operating model for TAHE. Further confusion accrues between different versions of TAHE that have been contemplated at different times.

Pre 30 June 2020, capital and operational maintenance prioritisation and allocation was performed by the maintainers (e.g. Sydney Trains for the MRN); RailCorp paid for capital initiatives on a recovery basis and cash settled with the maintainer, but did not settle for operational maintenance initiatives.

The TAHE long-term operating model sees a continuation of TAHE paying for capital initiatives under a fee for service arrangement via funding obtain as equity injections. Noting this funding strategy may change depending on its Corporate Strategy and apply alternate funding sources e.g. access fees.

The prioritisation and allocation of funding and the split between operational and capital maintenance funding will continue to be performed by Sydney Trains/TfNSW as part of the ASP and SASP process; however TAHE will now be required to 'endorse' the TOTEX level of funding that relates to its asset base.

This is consistent with observations noted in the Safety Considerations section (see **Section 1.2**), whereby: "TAHE requires assurance and governance mechanisms to verify that funding for asset maintenance critical failure modes are prioritised to prevent safety impacts to customer and community."

Accordingly, the long-term operating model now sees TAHE setting its required performance outcomes and developing an Asset Assurance Framework that will support the Board to discharge accountability to endorse maintenance funding; but sees TfNSW and Sydney Trains as the RIMS, accountable for the actual prioritisation of funding and actual delivery of maintenance.

With TAHE contemplating the development and ownership of its own commercial initiatives which are not subject to the TfNSW SASP and ASP process; TAHE will be accountable for its own asset management plans for these assets.

Accordingly, it has been useful to add a further segmentation to TAHE's assets within this section, between those subject to TfNSW attestation; and those for which TAHE will be liable.

The diagram below provides a high-level segmentation of the TfNSW attested and non-attested assets.

Figure 8: Segmentation of TAHE's assets

		Attest	ad Assets <sup>a</sup>		Non Altesido
	Spe	cialised		Non- Specialised	1000 10 <b>4</b>
5)	die of ellocation fellocie	nini nin	Ro" nastock .		是世
P	Track	A	Stations (inside paid area)	din	
000	Signaling & comms	1/2	Depots	e.g. Station non-paid	Surplus and other assets
538	Structure	đ	ICT & technology	area:	
	Other infrastructure	Dia.	Plant and equipment		

#### Source: TAHE project team

- Specialised Assets are the assets determined to be critical for safe and effective rail operations
- Designation would require consultation with TfNSW and Operators to, for example, balance the requirements for safe passenger flow versus more retail space
- Attested assets operated or managed by agencies required to comply with TPP17-07 NSW Asset Management Policy
- · Dependent on the SCI and Corporate Strategy

# Maintenance of TfNSW Attested Assets

The long-term operating model for TINSW attested assets has been developed to efficiently allocate accountabilities, reflecting logical accountabilities, existing requirements and the desire to reduce the misallocation of legal responsibilities to TAHE.

This sees TAHE accountable for developing its Asset Assurance Framework that it will rely upon to endorse asset maintenance funding and attest to the management of its assets; but sees TAHE reduce to being consulted in respect of 'tactical' decisions about what spending will be allocated to which assets over the near-term; in favour of TfNSW and Sydney Trains.

Again, reflecting safety inputs and logical accountabilities, the rail operators are responsible in all respects for the actual responsibility for undertaking maintenance tasks.

# Accountabilities for maintenance

Table 14: RACI for maintenance of TAHE's TfNSW attested assets

Function	Function Definitions	TAHE	TfNSW,	Sydney Trains*	NSW Trains
Maintenance: M	aintenance of the network and assets		V Fine Paris Killing	Television de la constantina	Name and
TAHE Asset Performance Outcomes	Sets outcomes based criteria for the management of TAHE assets.	A'/R	C	C	C

Function	Function Definitions	TAHE	TINSW	Sydney Trains*	NSW Trains
TAHE SASP	Sets plan and high-level policy for TAHE's assets.	C	A/R	C	C
TAHE ASP	Sets requirements to manage costs, risks and performance to meet service outcomes of TAHE assets.	C	Α	R	R
TAHE AMP	Maintenance, condition and performance plan for the assets, including expectations for maintenance funding.	C	A	R	R
Asset Assurance Framework	Implement assurance framework for TAHE assets and concluct 3 <sup>rd</sup> level of assurance activities over TfNSW systems and processes.	Α,	R	C	C
Asset assurance	Monitoring to ensure maintenance is performed in line with specifications set out in plans and asset standards on behalf of TAHE.	C	A/R	A/R	C
Variations	Endorse unforeseen identification, of maintenance; not within AMPs.	Α	R	R	С
Funding TOTEX maintenance	Endorse funding to M for operational and capital maintenance.	Α	R	R	С
Prioritisation of TOTEX maintenance	Prioritisation and allocation of funding to M for operational and capital maintenance.	C	A/R	A/R	j i <b>č</b>
Appointment of maintainer	Approval of appointment of an agent to deliver maintenance services on TAHE's behalf.	A/R	R*	R	
Maintenance services	The delivery of maintenance programmes in line with plans and service standards.	C	A*	A/R	C
Asset standards	Set Asset/Service standards across the Asset/Service lifecycle.	C	A/R	C	C

<sup>\*</sup> External service providers through TfNSW, such as CRN

At its core, the long-term operating model seeks to allocate TAHE required control over its assets through an assurance framework that sees TAHE with the accountability to assure itself, that those charged with the delegated authority to undertake maintenance activities, are doing so in accordance with its objective outcomes and relevant standards.

Through its assurance framework TAHE is required to endorse recommended funding envelopes year to year; but sees TfNSW or the public rail operators charged with the prioritisation and delivery of maintenance activities.

This seeks to delineate TAHE's overall strategic priorities and annual funding allocation activities; as separate to the tactical choices made by TfNSW and the operators about allocating the available funding across its priorities.

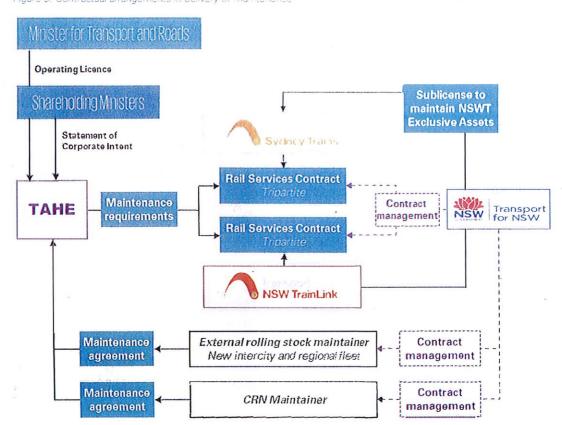
TfNSW is charged with setting the asset standards, which maintainers (RIMs and RSOs) are required to comply with under their RSNL accreditation and obligations. Those standards, along with TAHE's objectives and TfNSW's service requirements form the basis for RIMs/RSOs to develop their annual funding requirements. This is described below in further detail.

TAHE is contemplated as being granted the power to appoint/discharge the network maintainer; and is anticipated to require appropriate policies, frameworks and systems to assure itself that maintenance activities are appropriate and that its relevant asset maintenance requirements and TfNSW's standards are each being met.

It is anticipated that these accountabilities would be reflected in TAHE's operating licence, with section 14(2) of the TAA contemplating that the operating licence would determine the form of maintenance functions undertaken by TAHE. <sup>17</sup>

An overview of the contractual arrangements intended by the long-term operating model is outlined in Figure 9 below.

Figure 9: Contractual arrangements in delivery of maintenance



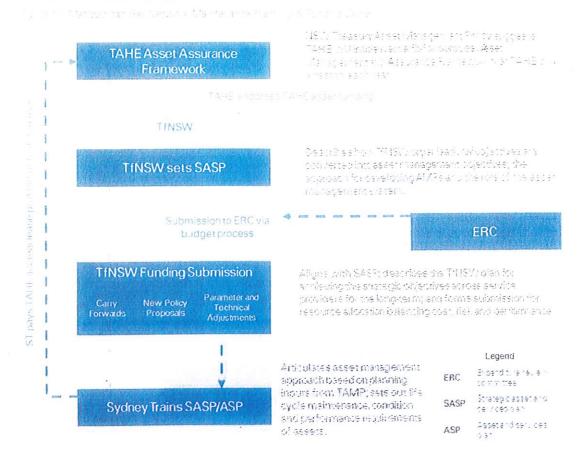
This framework seeks to distribute TAHE's maintenance responsibilities to appropriate accredited persons <sup>18</sup>; supported by appropriate assurance and reporting to the TAHE Board and TfNSW as appropriate.

<sup>17</sup> Section 14(2), TAA 1988 (NSW)

<sup>18</sup> Rail Safety National Law (NSW) No82a, Part 1, section 4 - Interpretation

TAHE is accountable for endorsing the total recommended level of maintenance funding for both capital and operational maintenance for its assets. Within endorsed funding the delivery partner/operator/maintainer and TfNSW will prioritise safety critical requirements to maintain.

The diagram below shows an example of the process to support TAHE's endorsement of the proposed maintenance investment programme for the Metropolitan Rail Network.



TAHE is accountable for developing its own Asset Assurance Framework which seeks to enable TAHE to make funding decisions and attest to the asset management of its portfolio in accordance with the NSW Asset Management Policy. It is worth noting that this is not mandatory for a SOC, but it is recommended in "TAHE asset and safety overview" that: "...safety and asset risks are managed and controlled adequately, and that a framework is agreed and enacted to meet compliance with core TfNSW safety and asset management standards."

In-principle this will set out how TAHE's asset management objectives are integrated with TfNSW's Asset Management Framework and the strategic and 'tactical' asset and services plans or SASPs and ASPs; and how TAHE's attestation will rely on the 'downstream' attestations provided by TfNSW and the O&Ms.

TfNSW's Asset Management Framework sets out a whole-of-life-cycle approach for managing Transport's assets; integrates the planning and budgeting for capital and recurrent expenditure as a total expenditure (TOTEX) outcome; and provides alignment to balance cost, risk and performance across the asset lifecycle.

TfNSW groups and agencies, including the public operators are responsible for developing Strategic Asset and Services Plans (SASP), which describe how organisational objectives are converted into asset management objectives across the cluster; and Assets and Services Plans (ASPs), sets out requirements to manage cost, risk and performance to meet required service outcomes.

# Sensitive: NSW Cabinet

Divisional and operator level assurance activities occur by the TfNSW groups and public operators to attest to the management of assets in accordance with SER asset management standards and compliance with the TfNSW Asset Management Framework.

These asset and service plans form an input into the Cluster Budget submission process and are used to inform the financial decision making for the Cluster, making sure total expenditure for the assets is considered.

TAHE will endorse the service and asset plans that relate to its assets, developed by the TfNSW groups and the operators only once the Board has satisfied itself via the assurance process TAHE's outcomes set in its Asset Assurance Framework are met.

Importantly, TAHE has no accountability for development of the service and asset plans and reduces to being consulted on throughout the development process. Once TAHE has endorsed the funding of the asset and service plans for its assets, the plans are incorporated into the funding submission to ERC for funding via the state budget process.

TfNSW will remain responsible for the administration of this coordination process, noting that the TAA allocates TfNSW power over:

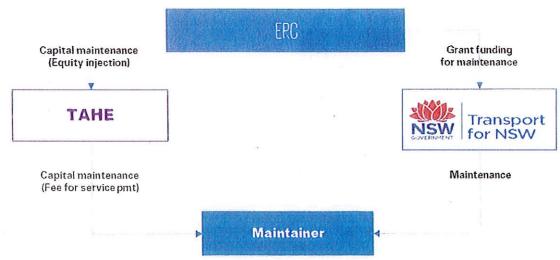
"The administration of the allocation of public funding for the transport sector, including the determination of budgets and programs across that sector, 19"

TAHE will be presented with recommended funding envelopes for different outcomes based on residual risks. TAHE is accountable to endorse the recommendation to be included in the funding submission relating to TAHE-owned assets; where a mechanism will be developed to resolve disputes or changes that TAHE may have to the proposed funding request.

Once funding is endorsed through the budget process, TAHE will need to again endorse allocation of funding that its service providers receive for the maintenance of its assets. This is funding that will impact TAHE's financial position given the fee for service arrangement.

A high-level funds flow diagram is shown in Figure 11 below.

Figure 11: Flow of funds for maintenance of TAHE's TINSW attested assets



Where a variation to funding requirements for operational assets arise, the maintainer will identify the variation and seek endorsement and a variation of funding from TAHE. TAHE will be consulted around any impacts to its asset base and the associated financial performance of its assets and endorse additional funding.

<sup>19</sup> TAA, Schedule 1. Part 1 (b)

#### Sensitive: NSW Cabinet

Assurance aspects are likely to prove to be a critical function for the TAHE Board in limiting and managing its liabilities for safety; but enabling the Board to satisfy safety requirements and attest to compliance with the asset management standards under the AMB charter, which includes applicable asset standard and asset management framework.

TAHE is required to comply with the ASA Charter under TAHE's operating licence which was previously a section 3G direction for RailCorp and Public Rail providers issued by the Transport Secretary.

In this context, the TAHE Board will need to assure itself that the assurance process and reporting by the O&Ms and by TfNSW is sufficient to satisfy its obligations as outlined in the independent safety advice; and secondly, that there are sufficient internal controls and governance to give reliance to the assurance activities.

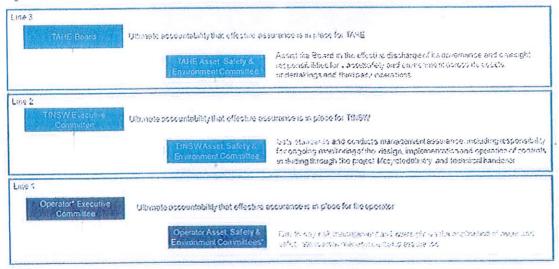
TAHE will need to develop a robust assurance framework that will provide sufficient oversight and assurance that assets are being managed in line with safety requirements and AMB standards. This forms part of the independent safety advice that can be found in the Safety considerations section (see *TAHE Asset and Safety Overview* letter by TfNSW in **Section 1.2**).

## In this regard;

- Operators and maintainers will conduct the first layer of assurance as required in their service agreements and under national rail safety law;
- TfNSW will conduct a second layer of assurance, given accountability for funding decisions under the contractual arrangements, as well as compliance monitoring with the asset standards – set by TfNSW;
- Operators and maintainers will comply with the reporting requirements and gather agreed performance monitoring information for the TAHE Board and TfNSW;
- The TAHE Board will leverage off these base layer reporting processes, conduct top up assurance
  processes where necessary and implement effective internal controls and review to satisfy reliance of
  the underlying assurance activities; and
- The TAHE Board will require monthly reporting from TfNSW and its operators on its assets performance
  to ensure assets are performing to standards, lifecycle performance objectives and are aligned to
  TAHE's SAMP. TfNSW also requires reporting to ensure compliance to its service objectives and longterm strategy.

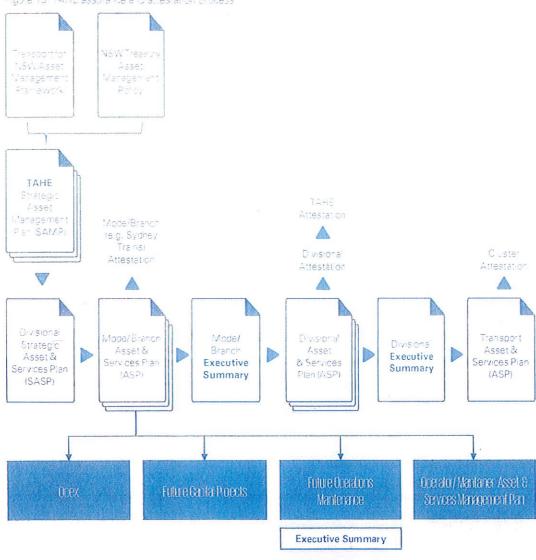
An overview of recommended assurance process is shown in Figure 12 below. This forms part of the independent safety advice found in **Section 1.2**.

Figure 12: Recommended TAHE assurance process



# An overview of attestation process is shown in Figure 13 below.

Figure 13 TAHE assurance and attestation process



# Sensitive: NSW Cabinet

# Maintenance of TAHE's TfNSW non-attested assets

TAHE management have represented their intent of pursuing investments and projects of a commercial nature that are not related to public transport; and therefore, not subject to TfNSW's planning, budgeting and attestation processes.

The opportunity and appetite for these commercial assets is still under development by TAHE and will largely be informed by TAHE's Statement of Corporate Intent and corporate strategy.

For the assets that are not attested to by TfNSW, TAHE will essentially be accountable for the maintenance of assets across the asset lifecycle, including planning, funding and maintenance of TAHE's assets. Noting TAHE may enter into arm's length arrangements to delegate responsibilities across these functions.

TAHE will also need to develop an asset management and assurance framework that will satisfy the Board that TAHE complies with legislative requirements (e.g. the WHS Act) and can attest to NSW Treasury in the management and performance of its assets, noting SOC's are encouraged to adopt elements of the policy where they align with the existing NSW Treasury policies that apply to Government businesses.



# TAHE's non-operational rail corridors

TAHE is the owner of 3,127km non-operational CRN railway line which must be maintained to ensure the local environment is preserved and that the public safety is maintained. Typical maintenance activities include:

- · Noxious weed and animal control;
- · Vegetation control where required;
- · Maintenance of fencing;
- Safety related inspection in relation to structures and level crossings;
- Other works to prevent undue or unfavourable local impacts; and
- · Any other work to rectify a safety hazard.







TAHE is an independent, for profit and commercial corporation – meaning it must have control over its linancial affairs – a key accountability for any fiduciary board.

Until now, TAHE has operated with relatively low levels of revenue compared to its extensive asset and cost base – with no access or lease charges from public rail operators for the use of TAHE's network or assets. Rather, TAHE has received equity injections from the Crown as required to fund the capital delivery program; and as noted in the maintenance section above; with TfNSW directly funding and controlling maintenance expenses and activities with Sydney Trains.

TAHE's long-term operating model contemplates TAHE financing its capital activities through debt or shareholder equity injections; funded via its regulated, unregulated and commercial revenues.

A key difference between TAHE and more typical SOCs like Sydney Water is the very large proportion of TAHE's revenue will be in the forms of access fees payable by public rail operators which are in turn funded by government CSO subsidies.

Accordingly, the long-term operating model's functional allocation has included the ERC/Cabinet within the RACI – noting that the CSO sought by the operators will be approved in the budget process; with downstream consequences on TAHE's ability to meet its revenue requirements.

# Accountabilities for finance and funding decisions

Table 15: RACI allocations for funding & financing

Function	Function Definitions	ERC	TAHE	TINSW	Sydney Trains	NSW Trains
Funding		1, 200,000				
Equity injections	Authorisation of quantum of equity funding.	A/R	C	ì	**************************************	-
CSO	Authorisation for subsidy to be provided to support the Rail operators to pay track access fees.	A/R	C	1		
Licence Fee	Sets pricing for licence fees.		A/R	C	<b>C</b>	C
Access Fees	Sets pricing for track access fees.		A/R		e	Č

Function	Function Definitions	ERC	TAHE	TfNSW	Sydney Trains	NSW Trains
Borrowing	Authorises target gearing ratio and debt raising.		A/R	1		
Grant Funding	Amount of grant funding to support TOTEX costs in relation to TAHE's assets.		A	A/R	C <sup>2</sup>	C:

TAHE's long-term operating model sees TAHE with independent control over the level and terms of its revenues (licence and access fees); as well as its borrowing. The degree of borrowing and gearing is tempered by each SOC's requirement to agree a Target Capital Structure (TCS) with the shareholders.

Unlike other more typical SOCs, for example Sydney Water, TAHE is contemplated as having public funding, via subsidies provided to the public operators and paid as access charges to TAHE, account for some 90 per cent of its overall revenues over the forward estimates.

While the functional allocation outlined above has sought to provide TAHE with demonstrable control over its funding and financing activities – it is obvious that the ERC's role in setting the level of equity, CSO subsidy and grant funding that could be expected by TAHE makes its financial independence appear limited in practice.

For example, while TAHE might negotiate commercial access charges and licence fees, if the ERC reduces the available subsidy to the operators, this will in turn see a reduction in TAHE's revenues.

By way of example, Sydney Water is different, principally because it owns and operates the entire water services market – and recoups its regulated costs directly from its customers.

As long as the operators are funded via CSOs to pay either access or licence fees, through the budget cycle process, TAHE will not be commercially exposed.

## Commercial activities

Commercial activities have been identified as a key driver for TAHE's creation; and are assumed to provide a growing quantum of capital returns and revenue to TAHE over time.

Depending on the scale and complexity of these commercial undertakings, TAHE will need to seek approval through the shareholder and the normal budgeting process.

Section 1.2: Safety considerations



# introduction

Our methodology section notes the complexities that exist within the heavily regulated rail transport sector.

Noting the stated preferences of the TAHE board and Cabinet's specific objectives on safety, and our exclusion of safety advice from our scope of work, we have relied on embedded safety inputs provided by the independent safety division within TfNSW's SER division.

As noted in the executive summary, we have applied a hierarchy to resolve inconsistencies that have arisen between Cabinet's objectives.

With the agreement of all stakeholders – this has been prioritised above all other objectives, including fiscal. SER's letter providing their safety opinion is attached below, which describes;

- The key legislative instruments governing safety, including section 10 of the TAA 1998, the Work Health and Safety Act 2011 (WHS Act) and Rail Safety National Law (RSNL);
- How TAHE must comply with the WHS Act and in particular, how it must demonstrate commercial
  imperatives are not prioritised ahead of safe and reliable rail assets;
- A proposed three lines of assurance model to facilitate the discharge of TAHE's safety and asset obligations;
- Proposed governance arrangements and assurance to give the Board the necessary line of sight over safety, environment and asset related matters; and
- The impact to TAHE of taking on the management of non-rail regulated assets.



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# TfNSW letter: TAHE Asset and Safety Overview

The following was prepared by TfNSW in August 2020



Appendix 1: CABINET IN CONFIDENCE TAHE asset and safety overview

# Background

In August 2020, asset and safety advice was sought from Transport for NSW to complete a review of TAHE's duffer and accountabilities, and provide advice of the impact and implications of the proposed functional model as recommended by KPMG.

Key deliverables included:

- Outline WHS and rail safety duties and asset management responsibilities for the existing RailCorp asset base for TAHE, TfNSW and third parties
- Analyse impacts and risks of the proposed future TAHE model to address and exercise safety and asset owner accountabilities
- Contribute to the strategic, tactical and operational arrangements necessary to address legislative safety duties and asset management responsibilities in the proposed structure

## Summary

- TAHE's objectives are set out in section 10 of the Transport Administration Act 1988.
   All five of TAHE's objectives are of equal importance. One of TAHE's objectives is to undertake its activities in a safe and reliable manner.
- The Work Health and Safety Act 2011 (WHS Act) and Rail Safety National Law (RSNL) are the key legislative instruments governing safety in regards to TAHE and its assets. The safety duties imposed by legislation cannot be delegated or contracted although the extent of application will depend on the business and undertaking of the relevant entity. The model proposed will see TINSW and rail operators responsible for the accreditation requirements as a Rail Infrastructure Manager.
- In compliance with the WHS Act. TAHE must demonstrate commercial imperatives
  have not been prioritised ahead of safe and reliable rail assets, whilst balancing the
  delivery of profitable returns. TAHE requires assurance and governance mechanisms to
  verify that funding for asset maintenance critical failure modes are prioritised to prevent
  safety impacts to customer and community.
- A three lines of assurance model is proposed with a committee governance structure to
  facilitate the discharge of TAHE's safety and asset duties. The Board should implement
  sufficient processes to be assured that safety and asset risks are managed and controlled
  adequalety, and that a framework is agreed and enacted to meet compliance with core
  TrinsW safety and asset management standards.
- In accordance with TAHE's operating licence, TfNSW set the network and asset standards and provide technical assurance for the standards
- Governance arrangements with robust internal controls and assurance give the
  Board members the necessary line of sight over safety, environment and asset
  matters. This allows the Board to meet their due diligence obligations of monitoring and
  having resources and processes in place to receive information. The TAHE board should
  not rely solely upon the information presented to them by internal control processes and
  reporting systems, although this is the primary means of assurance and oversight. As part

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TAHE's proposed model of taking on management of non-rail regulated assets
requires appropriate residucing to fulfill asset environment and safety duties it to
anticipated this will notice a three intentity asset environment and its FaHE address
processes and instruments to manage and leaster takes and residure to it matter
enact TAHE's asset environment and used in this.

# Safety duties

The WHS Act 2011 applies to all activities of a Pelson Conducting a Business of Undersoring (PCBU) and creates individual outles of due difigence for officers of the FCBU. The RSHE provides a regulatory framework around rativaly operations and rativally premises. The WHS Act prevails to the extent of any gap or inconsistency. The general duties in the VHS Act and RSHE are aligned.

Under the operating model proposed. TAHE will not be classified as a Rail infrastructure Manager and therefore, will not require RSNL appropriate as TITEM and time parties are conducting this to el. However if TAHE take on a more substantial to eith railway operations (gg commission management of railway premises). RSNL appropriation management of railway premises. RSNL appropriation management as Rail Infrastructure Manager.

In the with the RACI detailed in the KPMG documentation. TAHE will be variously accountable responsible and consulted in regards to its asset base. These aleas will require reasonably practicable activities to facilitate the discharge of work health and safety duties. In add ton to the extent TAHE determine to manage construct and maintain non-radingulated assets relevant general work health and safety duties will apply to its activities requiring appropriate resources and processes to facilitate safe operations and oversight. Horably, if TAHE directly commissions construction work in excess of \$250,000 (including infrastructure and maintenance activities). Principal Contractor duties will apply under the WHS Act.

All governance frameworks involve a set of processes, controls and mechanisms being the traditional domain of governance and due difigence. However, culture is especially relevant to safety which depends on the behaviours and attitudes of a large number of people.

The due diligence requirements in section 27 of the WHS Act should be viewed as the Milithium required to discharge a duty of due diligence. In addition to the assurance and governance mechanisms discussed below is safety due diligence framework is recommended to support and guide TAHE achieve its primary outles.

# **Asset management**

Under the current operating licence, TAHE must comply with the Asset Standards Requirements of Transport for HSW. While it is noted this licence will be renegotiated any future ittence should not girm high the requirement for independent settling of, and technical assurance to, those standards.

The proposed model provides assurance to TAHE that minimum standards are set, monitored and tested across its asset case by TfNSW. Any concessions are governed and assured through the same process.

The Asset Standards Requirements currently consist of the asset standards published by the TfNSW Asset Management Division and the TfNSW Safety Management System

Tft1SW including Sydney Trains and NSW Traigligh, are required to adopt the NSW Treasury Asset Management Policy (TPP 19-07). Amongst other elements the Policy requires preparation and annual attestation of a Strategic Asset Management Plan and Asset Management Plan. As the asset owner TAHE will need to attest to compliance with the Policy in relation to their assets.

Transport for NSW T 02 8202 2702 18 Lee larger Carponisso NSW 2009

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operated and managed through TfNSW. As a SOC, TAHE are not required to comply with the Policy in relation to their assets that are not managed and operated through TfNSW, however the Policy encourages compliance at least with the key aspecis.

# Asset and safety assurance model

The review proposes the adoption of an assurance model similar in the KPMG three lines of defence (Figure 1). The benefits of this model include:

- Addresses varying responsibilities of interconnected parties
- Facilitates a model in which prior learnings are implemented
- Supports accreditation outcomes (whether to ISO standards or RSNL)
- Discharges duties across various stakeholders
- Minimises unforeseen liabilities by having clear roles and accountabilities



Figure 1: KFIA3 three lines of defence model

This model facilitates TAHE being assured that compliance with the asset standards have been tested  $v_T$  the operator / <u>maintainer\_and</u> confirming compliance with the asset standards is met through their own assurance activities as the operator / maintainer

Figure 2 shows the proposed assurance model for rail regulated assets in application, an internal assurance model will be necessary for TAHE to discharge its safety and asset duties for non-rail regulated assets in line with better practice.

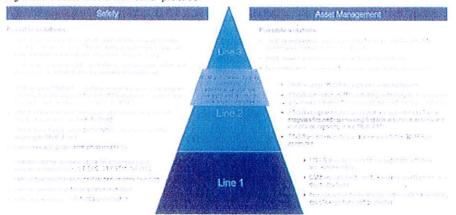


Figure 2: Proposed assurance model for rail regulated assets

This model distinguishes the board as a governing body, providing a line of separation from management and operational accountability for rail-regulated assets.

**KPMG Highly Confidential** 

#### Sensitive: NSW Cabinet

# Asset and safety management relationships

The interface and intermelationan bailism. The above through to the coets male passanglers and operators is reflected in Figure C.

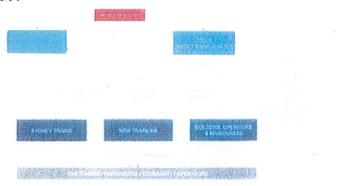


Figure 3. Asset and Safety relationships for rail-regulated assets

# TAHE asset and safety governance

Appropriate governance structures enable the TAHE Board to have confidence that safety asset issks are appropriately controlled in a consistent and effective manner based on a valid assessment of risk and risk freatments. Figure 4 reflects the proposed governance mechanisms for rail regulated assets to facilitate the relevant flow of information.

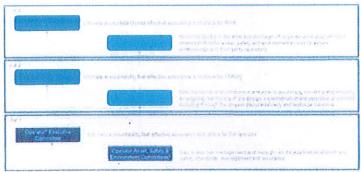


Figure 4. Proposed committee governance structure to TAHE Board

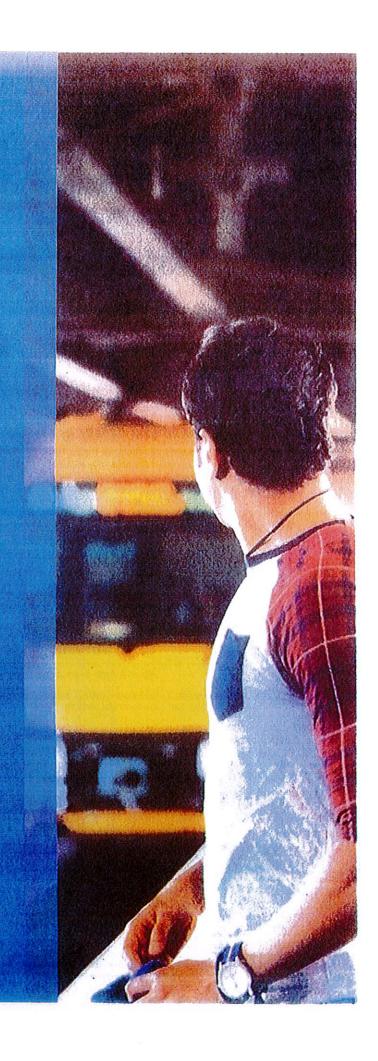
If is recommended TAHE Board establish a dedicated sub-committee to provide focussed attention on asset, safety and environmental matters. The role of the sub-committee would be to assist the Board.

- in the effective discharge of its governance and oversight responsibilities for asset, safety and environment across its assets, undertakings and third paths operations; and
- in obtaining assurance that appropriate frameworks and systems are in place to deal with the management of asset, safety and environment risks; and
- to review the performance of transport agencies and delivery partners in these areas and their compliance to those frameworks and systems.

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Section 2: Financial performance



# The KPMG TAHE Financial Mede

Our June report to Cabinet identified financial modelling limitations precluding a more detailed and accurate basis to analyse TAHE's costs and net benefits.

Accordingly, a key output of our scope of work is the more sophisticated 'KPMG TAHE Financial Model'. This uses current data and agreed assumptions to show:

- The required access and licence fees;
- The calculation of Full Economic Cost to understand compliance with price bounds;
- A preliminary basis for revaluation on an income approach; and
- Financial impacts on the NSW Budget, TAHE and TfNSW.

Alongside the methodology (See Methodology), we have outlined each stage in the development of the KPMG TAHE Financial Model; reflecting the importance of TAHE's financial performance to Cabinet's objectives and the need for stakeholder agreement on the model's inputs, function and detailed outputs.

# Stage one - agreed inputs & assumptions<sup>20</sup>

We circulated our modelling assumptions to relevant NSW Government stakeholders to allow for an agreed set of assumptions. For transparency, the model assumptions are described below:

- Access Fees: Our model provides two core access fee functionalities, the first being a model input to
  determine financial outcomes, compliance with IPART bounds, and TAHE commerciality; the other being
  model outputs determining the level of access fee required to achieve TAHE's target commercial
  outcomes
- Licence Fees: For simplicity, licence fees were determined using the same 'building block' model input that was applied to calculate the regulated asset ceiling, but with an unregulated WACC.
- Resourcing and other overheads: We have used simple FTE calculations for resourcing levels agreed with TAHE and TfNSW.
- Equity injections and grant funding: forward equity injections are derived from the budgeted movements in TAHE's contributed equity in PRIME. Grant funding to operators are also obtained from PRIME, noting that additional appropriations to cover COVID-19 related farebox revenue impacts are already factored in.
- Capital investment programme: We have used TfNSW's 10-year TIP as the key input for capital major
  rail delivery; with a 'Fee for Service' payable by TAHE to the relevant entities who deliver these projects
  on TAHE's behalf so that they can recover costs. Currently, TAHE has projects delivered on behalf of
  them by TfNSW, Sydney Trains and Sydney Metro. This includes capital maintenance.
- Operating maintenance costs: We used Sydney Trains maintenance budget in PRIME for the MRN;
   CRN operating maintenance costs were obtained from the CRN Asset Management Plan.
- Asset valuations: We have valued TAHE's assets using the 'cost approach'; based on 'Depreciated Replacement Cost'.
- Asset write off: We assume there is no write off in TAHE's asset value, based on ongoing discussion with NSW Treasury.
- Borrowings: The model has capability to assume different gearing levels over time; however, based on TAHE and NSW Treasury input we have assumed that the level of borrowings remain unchanged.
- Dividends to the Crown: dividends are calculated as 70 per cent of NPAT but limited to the lower of net profit after tax, retained earnings and retained cash. Additional functionality exists to set a target ROE and determine revenue targets to be met via Access Fees.

Assumptions discussed at numerous meetings with NSW Treasury, including on 14/08/2020, 18/08/2020, 20/08/2020, 15/09/2020, 23/09/2020 and 02/10/2020.

 Tax equivalent payments: tax equivalent payments are treated as income to the general government sector; calculated as 30% of NPAT after accumulated tax losses are utilised.

# Stage two - agreed Model architecture

Figure 14 below shows the inputs, architecture and outputs of the KPMG TAHE Financial Model. This was developed and refined through ongoing consultation with NSW Government stakeholders.

Prime foreword ST maintenance CRN maintenance estimates programme programme Data TfNSW Fixed Asset Target ROE Target gearing ratio Register TfNSW 2017 Cost IPART WACC and Current train volumes (TKMs, GTKs and and Access Pricing compliance train paths) model (updated) assumptions The TAHE financial model has four key functionalities Events level financial results 4 calculates (IPAT and incremental change for each entity 10.65 phypact - calculares oversil GGS net incremental impact agramm the Base Case scenario Asset value DCF - calculates regulated and unregulated asset values applying the 'income approach' 4. Access ceiling/floor - determines the MAR based on IPART methodology and assumptions Entity level Cash balances and Net incremental financial results flow of funds GGS impact Model outputs ROE for TAHE IPART compliance DCF asset values shareholders

## Stage three - agreed scenarios

While our TAHE Financial Model has sophisticated functionality to model any variation of the agreed inputs and assumptions, both for simplicity and reflecting stakeholder feedback, we provide two TAHE scenarios – reflecting the operating model and assumptions outlined in this section, above but with different assumptions applied where KPMG and Treasury's view diverge.

Noting Cabinet's request to better understand TAHE's fiscal and financial aspects, we have derived estimates under two scenarios and compared against NSW Treasury's June Cabinet Submission estimate.

- Scenario 1: KPMG's preferred assumptions: This scenario applies KPMG's assumptions based on consideration of feedback from all NSW Government stakeholders (detailed above and below) and shows a detailed projection of TAHE's benefits and costs.
- Scenario 2: NSW Treasury's preferred assumptions: This scenario applies NSW Treasury's preferred assumptions where they have diverged from KPMG's view (detailed below) and shows a detailed projection of TAHE's benefits and costs.<sup>21</sup>
- Comparator: June Cabinet Submission estimates: For consistency with the figures included in the June Cabinet submission, we have measured TAHE against the current state whereby TAHE sees benefits, but no costs<sup>22</sup>.

We describe the assumptions for each scenario below.



<sup>&</sup>lt;sup>21</sup> Assumptions discussed at numerous meetings with NSW Treasury, including on 14/08/2020, 18/08/2020, 20/08/2020, 15/09/2020, 23/09/2020 and 02/10/2020.

<sup>&</sup>lt;sup>22</sup> Assumptions discussed at numerous meetings with NSW Treasury, including on 14/08/2020, 20/08/2020, 15/09/2020, 23/09/2020 and 02/10/2020.

# Overview of assumptions

Sensitive: NSW Cabinet

# anario 1: KPI/iG's preferred assumptions

The scenario with KPMG's preferred assumptions models TAHE as a commercial PNFC corporation, earning a commercial return on its asset base and providing a commercial return – as needed to satisfy its fiscal objectives and sustain its PNFC designation.

#### Key assumptions relevant to this scenario are:

- Regulated access fees to public and private operators start at \$0.00 in FY21, \$700m pa in FY22 and ramp up to \$3.2 billion in FY25 in line with target ROE.
- The ROE profile has been assumed to be 1-3% from FY23 to FY27 and 4% onwards.
- In periods where required access fees to achieve the target ROE are above the IPART ceiling, the ceiling price is applied and target ROE is not achieved.
- The ROE has been calculated using TAHE's net assets with \$37.9 billion as at FY21.
- Unregulated licence fees to public and private rail operators are consistently charged at the 'floor' price, commencing at \$120m in FY23 and ramping up gradually to \$127 million in FY25.
- This slow ramp up moderates the negative effects over the forward estimates
- We calculate regulated and unregulated fees via a BBM, applying regulated and unregulated WACCs respectively.
- TAHE's capital and operating expenses (TOTEX) are contemplated as being 'netted off' against access and licence fees.
- Capital maintenance is capitalised onto TAHE's balance sheet.
- Revenue streams currently with Sydney Trains worth >\$100m pa are redirected to TAHE worth >\$1bn over the 10-year evaluation period.
- TAHE funds the capital major rail delivery programme via a combination of equity injections from the Crown and free cash flow.
- TfNSW continues to administer the funding and budgeting process, providing grant funding to TAHE's service providers which is netted off against the access and licence charges to be paid to TAHE
- TAHE pays dividends at a 70% payout ratio in all periods where it earns a net profit after tax and has sufficient retained cash to do so
- TAHE endorses the quantum of maintenance funding for its assets

Based on these assumptions, the financial model generates the following outputs:

FY21 net fiscal impact	+\$1.2 billion.
Net fiscal impact based on a 4-year forward estimate	-\$0.2 billion
Net fiscal impact based on a 10-year forward estimate	-\$5.3 billion

Sensitive: NSW Cabinet

NSW Treasury has put forward a set of assumptions to be tested in order to determine the net fiscal impact to the NSW Government; as these assumptions are different to KPMG's preferred assumptions, we have presented this as a separate scenario.

#### Key assumptions relevant to this scenario are:

- Regulated access fees to public and private operators start at \$700m in FY22, held at \$700m until
   FY24 and ramps up to \$2.2bn in FY25 in line with target ROE.
- The ROE profile has been assumed to be a flat 1.31% based on the current 10-year government bond rate
- The ROE has been calculated using the contributed equity with \$10.8 billion as at FY21
- Unregulated licence fees to public and private rail operators are consistently charged at the 'floor price, commencing at \$120m in FY23 and ramping up gradually to \$127 million in FY25.
- This slow ramp up moderates the negative effects over the forward estimates
- We calculate regulated and unregulated fees via a BBM, applying regulated and unregulated WACCs respectively.
- TAHE is not required to make a dividend payment until FY25.
- TAHE's capital and operating expenses (TOTEX) are contemplated as being 'netted off' against access and licence fees.
- Capital maintenance is capitalised onto TAHE's balance sheet
- Revenue streams currently with Sydney Trains worth >\$100m pa are redirected to TAHE worth >\$1bn over the 10-year evaluation period.
- TAHE funds the capital major rail delivery programme via a combination of equity injections from the Crown and free cash flow.
- TfNSW continues to administer the funding and budgeting process, providing grant funding to TAHE's service providers which is netted off against the access and licence charges to be paid to TAHE
- TAHE pays dividends at a 70% payout ratio in all periods where it earns a net profit after tax and has sufficient retained cash to do so
- TAHE endorses the quantum of maintenance funding for its assets

NSW Treasury's assumptions see an improvement in TAHE's performance with the following outputs:

FY21 net fiscal impact	+\$1.5 billion.
Net fiscal impact based on a 4-year forward estimate	+\$4.3 billion.
Net fiscal impact based on a 10-year forward estimate	+\$4.7 billion.

<sup>&</sup>lt;sup>23</sup> Assumptions discussed at numerous meetings with NSW Treasury, including on 14/08/2020, 18/08/2020, 20/08/2020, 15/09/2020, 23/09/2020 and 02/10/2020.

Arr Eliversus the June Cabinet Submission estimates

During its transitionary period, TAHE has provided fiscal benefits, without imposing fiscal costs. Until the commencement of access fees on 1 July 2022, TAHE has enabled expenses to be placed into TAHE, without the need for revenues to support a profitable corporation.

The main fiscal benefit during this transitionary period was derived from the continued for-profit PNFC status granted to TAHE, enabling capital injections from the Government to be treated as equity rather than a grant expense. Beyond this transitionary period, the main fiscal benefit is derived from having TAHE absorb rail depreciation costs rather than the budget.

We have included the incremental difference from the status quo, to TAHE as below – noting that this was the basis of the numbers provided to Cabinet in the June 2020 Cabinet submission.

This scenario provides a clear basis to understand TAHE's net fiscal benefit and allows for a consistent basis for comparison to the June Cabinet Submission.



#### A single TAHE operating model – with two sets of assumptions

For simplicity, we have modelled a single TAHE operating model which is agreed between all NSW Government stakeholders. Again, for simplicity, the detailed results have been measured against financial estimates provided in the June Cabinet Submission (see: Comparator – June Cabinet Submission estimates).

While we present a single operating model – this has been subject to two different sets of assumptions, seeing a 'range' rather than a single results line.

KPMG spent considerable time consulting with NSW Treasury, TAHE and TfNSW officers to develop agreed scenarios.

Consultations with Treasury's commercial division saw suggestions that TAHE should assume a target ROE with an upper bound of 7 per cent and a lower bound of 1-3 per cent.

Treasury's commercial division noted that the most comparable entity in scale is Sydney Water which achieved a ROE of 6.2 per cent in FY19<sup>24</sup>.

Noting the subjectivity of this input into the model, Treasury initially requested that a scenario reflected access fees at a level that provided for a 4 per cent ROE, commencing in FY21.

This scenario sees TAHE breach the NSW RAU price floor with total access fees at some \$1.3bn in FY21, consisting of maintenance and overhead costs only.

The impact on the Budget applying this initial scenario, measured against the estimated financial impact in the June Cabinet submission is reflected in the adjacent table.

	FY21 (Budget Year)	Forward Estimates (4 year)	10 Year Estimate
June Cabinet Submission – Treasury estimate	+\$1.8bn	+\$7.4bn	AW
TAHE (Treasury scenario with initial Treasury essumptions)	+\$1.5bn	+\$4.3bn	+4.7bn
Change – June Treasury vs. Treasury preferred assumptions	-\$0.3bn	-\$3.1bn	M/A

#### Adjusting assumptions:

Noting the sensitivity of unanticipated fiscal impacts, NSW Government stakeholders have worked hard to consider how key assumptions might be adjusted to better portray TAHE's actual performance.

<sup>&</sup>lt;sup>24</sup> Sydney Water, FY19 annual report.

#### Sensitive: NSW Cabinet

KPMG has maintained a detailed change request log, showing Treasury's requested changes over the course of the model's development and finalisation; with KPMG accepting all save several, shown in the table below.

Table 16: Overview of assumptions by scenario

Assumption	KPMG preferred assumptions	NSW Treasury preferred assumptions
Access fee start date	2022	2022
ROE Profile	1-3% from FY23 to FY27, 4% onwards.	Flat 1.31% at current 10-year government bond rate, starting in FY25.
Denominator to calculate ROE	Net assets (\$37.9bn as at FY21).	Contributed equity from 2015 (\$10.8bn as at FY21).
Inclusion of additional top up funding to ensure the public operators breakeven?	Yes	No .

#### Access fee start date:

Treasury subsequently requested that access charges ramp up to a commercial level from FY25, beyond the next election. This is a highly beneficial assumption, noting that it serves to push most of TAHE's budget costs beyond the forward estimates.

Noting the focus by NSWAO and other stakeholders on TAHE's accounting bona fides and Cabinet's fiscal and sustainability objectives, we have not accepted this assumption in the KPMG preferred assumptions.

Instead, we have applied access fees ramp up commencing in FY23 at 1 per cent, increasing to 3 per cent by FY27 and at 4 per cent thereafter.

## ROE profile:

NSW Treasury initially requested a starting return of 4 per cent,  $^{25}$  noting the need for a defensible level of pricing and financial return; but later reduced this several times. Presently, NSW Treasury and TAHE have requested that TAHE's equity returns be set at the 10-year sovereign (risk free) borrowing rate  $^{26}$  – and held constant for the evaluation period.

#### **ROE** denominator:

As noted in the case study in **Section 1**, TAHE's true depreciation costs are double those assumed by Treasury prior to 30 June 2020; seeing cash 'trapped' to fund much higher asset depreciation costs.

NSW Treasury have requested that TAHE's ROE be calculated only on the equity invested since 2015; not its overall net asset base<sup>27</sup>. This sees the FY21 ROE denominator reduce from \$37.9 billion to just \$10.8 billion in Treasury's preferred assumptions.

#### Reducing the return requirement reduces budget costs:

This sees ROE calculated on assets worth 75 per cent less than TAHE's valuation; reducing its budget impacts and improving TAHE's overall fiscal benefit by \$3.6bn billion over the forward estimates.

<sup>25</sup> Discussed at access pricing workshop on 28/08/2020.

<sup>&</sup>lt;sup>26</sup> Written comments received from NSWT on 28/09/2020.

<sup>&</sup>lt;sup>27</sup> Written comments received from NSWT on 28/09/2020

#### Treasury's view of ROE denominator:

Treasury are of the view that the ROE denominator should only include the capital invested since 2015<sup>28</sup> which would bring the required fees down from \$5.7bn to \$2.1bn over the FEs.

Treasury provided the following feedback on the ROE denominator:

"This model currently seems to solve for ROE required using total net assets as the denominator, and no scenario calculated envisions RoE where Crown equity contributions capitalised since 2015 is the denominator. Given capex funding pre-2015 has already been expensed by Government (on the basis that no return was expected on these amounts), it does not appear appropriate to use total net assets as the denominator when solving for a target RoE."

"The rate of return is calculated by comparing:

- o the current values of equity injections provided by the government; with
- the current value of returns that the government will receive in the form of dividends, capital returns and proceeds of sale, if any."

Figure 15: Overview NSW Treasury rate of return formula



\* Devidends "below the line" are technically holding grams for newathelps selecting part of the return to NSW Government (ABS GFSM 2015, 13, 63)

Source: Treasury information provided to KFA1G

#### Corporate Finance Theory:

In finance and accounting there are frequent references to returns on investments and different definitions to these terms. It is useful in defining these terms to consider a balance which defines Assets, Liabilities and Equity (or the owner's funds).

ROE is not a measure defined in International Financial Reporting Standards, but is derived from the underlying accounting values.

ROE relates to the earnings left over for equity investors after debt service costs have been factored in to the equity invested in the asset. Noting that the book value of equity reflects retained earnings.

The accounting definition for ROE:

$$Return on Equity = \frac{Net \ Income_t}{Book \ Value \ of \ Equity_{t-1}}$$

Source: Return on Capital (ROC), Return on Invested Capital (ROIC) and Return on Equity (ROE): Measurement and Implications, Stern School of Business; Principles of Corporate Finance, McGraw-Hill International Editions

Equity is defined as: "The residual interest in the assets of the entity after deducting all its liabilities Shareholders". TAHE's residual interest in its assets after deducting liabilities is \$37.9bn.

This definition is highly important given ROE is considered a measure of how effectively management is using a company's assets to create profits.

Noting NSW Treasury's comment that capex funding pre-2015 has already been expensed by the NSW Government; this would have previously constituted a revenue line item to RailCorp and would still be captured within its retained earnings balance.

<sup>&</sup>lt;sup>28</sup> Expressed through written comments provided by NSWT on 28/09/2020

#### Other SOCs application of ROE:

Treasury's Policy TPP18 outlines that government businesses are required to develop an annual SOI and comprehensive Business Plan based on agreed financial and non-financial targets.

Government businesses are required to provide quarterly performance reports to Treasury. Treasury uses these reports to analyse and assess businesses' performance outcomes.

We have outlined the disclosed target ROEs within the most recent SCI's from several SOCs, noting these ROEs appear to be calculated on the basis consistent with our understanding in the FY19 annual reports:

Statutory SOC	FY21 Reported ROE
Hunter Water Corporation	3.6%
Landcom	14%
Newcastle Port Corporation	7.2%
WaterNSW	Not disclosed
Forestry Corporation	9.1%
Essential Energy	0.7%
Sydney Water Corporation	6.20%
Average ROE	6.8%

Source: Online SCI's, FY19/20
\*As disclosed in FY19 Annual Report

#### Does KPMG disagree?

We have reviewed the financials of relevant SOCs, the NSW Government's undertakings to the ABS and corporate finance theory to assess the reasonableness of this assumption. These inquiries have shown:

- NSW Treasury's information provided to the ABS in its 2015 request for determination states that RailCorp's net assets would transfer to TAHE by way of equity. The ABS would therefore expect a return on the net assets to be achieved.
- Corporate Finance Theory, as outlined below, suggests that the evaluation of a return on equity should also reflect retained earnings within the denominator.
- Other SOCs in NSW appear to calculate and report on ROE in a manner consistent with our understanding – where the net assets are included as the denominator.
- TAHE Board's accountability for its assets and understanding the performance of the assets will
  require financial reporting on its entire portfolio.

In the absence of compelling precedent, KPMG has opted not to adopt Treasury's preferred denominator to calculate ROE.

Noting the Cabinet's requirement for detailed analysis of TAHE and the problems posed by prior modelling assumptions that lacked supporting evidence – most particularly, the assumed write down of TAHE's asset values.

For these reasons, KPMG has not accepted Treasury's suggested 75 per cent reduction in the ROE denominator.

## Overview of results

#### gence between Scenarios

Scenario 2 (NSW Treasury's assumptions) see an improvement in TAHE's performance when compared to scenario 1 (KPMG's preferred assumptions). This is predominantly driven by the target ROE profile applied and the inclusion/ exclusion of additional grants to public operators.

#### **Target ROE Profile**

Scenario 1 (KPMG's preferred assumptions) sees the target ROE profile ramp up slowly in line with the expectation that a SOC is expected to mature and provide a higher return; increasing from 1 to 3 per cent from FY23 to FY27 and then remaining at a flat 4 per cent from FY27. As a result, this scenario requires significantly higher CSO subsidies. Scenario 2 (NSW Treasury's assumptions) prefers a target ROE which remains constant at 1.31% for all periods, resulting in a logical greater fiscal benefit.

#### Additional grants to public operators

Scenario 1 (KPMG's preferred assumptions) includes additional funding to ensure the public operators breakeven on an accounting basis; amounting to \$2.5bn of additional costs over the forward estimates period and \$7.3bn over the 10-year period. This causes a significant detrimental fiscal impact. Scenario 2 (NSW Treasury's preferred assumptions) does not consider this cost.

Table 17 provides a summary of the net fiscal impacts to TAHE across the two scenarios with the delta when compared to the June Cabinet submission.

Table 17. Estimated net fiscal impacts to TAHE

Manual Canada Cara ang Panganda Banganda Banganda Banganda Banganda Banganda Banganda Banganda Banganda Bangan Banganda Banganda Ba	FY21 (Budget Year)	Forward Estimates (4 year)	10 Year Estimate
Comparator: June Cabinet Submission – Treasury estimate	+\$1.83bn	+\$7.39bn	N/A
Scenario 1: KPMG preferred assumptions)	+\$1.2bn	-\$0.2bn	-\$5.3bn
Change from comparator (June Cabinet Submission)	-\$0.6bn	-\$7.2bn	N/A
Scenario 2: NSW Treasury preferred assumptions	+\$1.5bn	+\$4.3bn	+4.7bn
Change from comparator (June Cabinet Submission)	-\$0.3bn	-\$3.1bn	N/A

Figure 16 below bridges the difference between Scenario 1 (KPMG's preferred assumptions) and the Comparator (June Cabinet Submission estimates).

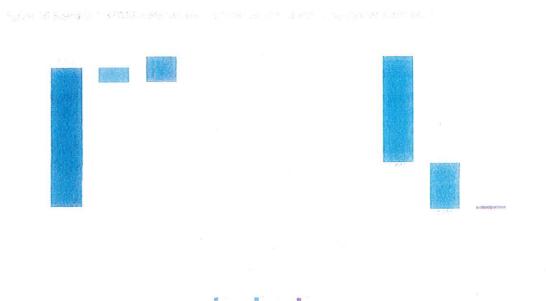
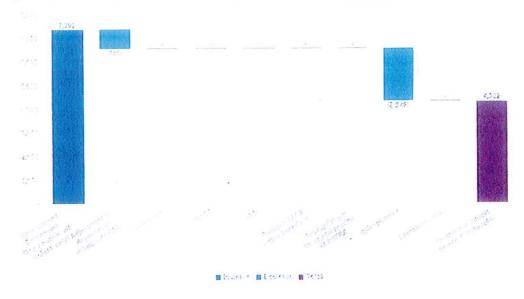


Figure 17 below bridges the difference between Scenario 2 (NSW Treasury's preferred assumptions) and the Comparator (June Cabinet Submission estimates).





# Financial model detailed results

#### Detailed entity-level assessment of TAHE

Below is a detailed assessment on the impacts of TAHE at the entity level for the two scenarios presented.

#### Scenario 1: KPIAGIs preferred assumbtions

This scenario sees TAHE reaching a net profit after tax position in FY23. In the years prior to this, TAHE is at a net loss after tax position; (\$1.5bn) in FY21 and (\$0.9bn) in FY22. TAHE begins to pay dividends from FY23 to meet its target ROE and increases over time in line with NPAT.

TAHE retains a healthy cash balance; funded by equity injections and significant access and licence fee payments from operators which ramp up to some \$2.0bn by FY25.

To provide detailed insight, we have described the model across three aspects; being revenue, dividends and access fees. Detailed analysis and discussion in relation to these categories is outlined in the sections.

#### Revenue

Earning a commercial revenue is integral to sustaining TAHE's for-profit PNFC and 'for profit' status into the long-term. Scenario 1 (KPMG's preferred assumptions) considers two key sources of commercial revenue; access fees and licence fees.

While TAHE contemplates potential future returns from commercial activities and development, we are advised the detail is to be developed and agreed with Voting Shareholders. For the purpose of the financial model we assume any benefits will be beyond five years and therefore, are not relevant to this assessment.

Under the applied transitional plan which phases in access and licence fees, TAHE does not earn a net profit after tax until FY23 but consistently sustains a net profit after tax position thereafter:

- In FY21, no access or licence fees are earned, resulting in an NPAT of (\$1.5bn).
- In FY22, no licence fees are earned but \$700m of access fees are earned, resulting in an NPAT of (\$0.9bn).
- In FY23, \$0.2bn of licence fees and \$2.3bn of access fees are earned, resulting in an NPAT of \$0.9bn.
- From FY24 onwards, TAHE consistently maintains a net profit after tax position.

Over the two initial years where TAHE is in a net loss after tax position, tax losses are accumulated and then subsequently utilised in FY23 and FY24. TAHE becomes liable for tax equivalent payments from FY25 after all previously accumulated tax losses are utilised.

#### Dividends

The 2015 ABS determination notes an expectation of dividends on all assets transferred to TAHE via equity. However, detailed modelling reveals that TAHE serves to 'trap' a large portion of its access and licence fee revenues, because TAHE's asset value is much higher than the 50 per cent write-off assumed in NSW Treasury's May 2020 financial model.

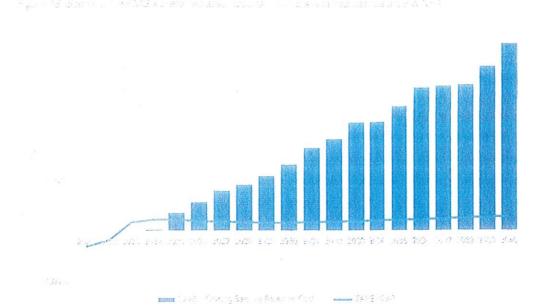
TAHE has instructed us to assume a 70% dividend payout ratio; noting a limitation of the model where a regular dividend payment is calculated for all periods earing a profit and cannot factor in discretionary powers of the TAHE Board. Modelling of Scenario 1 (KPMG's preferred assumptions) indicate the following:

- No dividends are paid in the first two years (FY21-FY22) as TAHE incurs a net loss after tax.
- TAHE begins paying dividends in FY23 of \$0.6bn.
- By FY25, TAHE's dividend ramps up to \$0.7bn in line with target ROE of 2 per cent; thereafter TAHE is
  unable to achieve the target ROE profile due to the ceiling cap on access fees.

As a corporation, TAHE can only pay dividends out of NPAT, after non-cash depreciation costs are accounted for. It is an ongoing management assumption for the financial model that TAHE will be expected to provide dividends from after tax profits to shareholders, comparable to an equivalent private sector business. Figure

#### Sensitive: NSW Cabinet

18 below shows the accumulation of retained cash in TAHE under the TAHE scenario with KPMG's preferred assumptions.





#### TAHE's (much) higher asset value see (much) higher non-cash depreciation costs

NSW Treasury's May 2020 financial model was used to inform previous considerations of TAHE, including as a basis to inform estimates used in the June Cabinet Submission. The Treasury model applied an assumption that 50 per cent of TAHE's asset value would be written off.

Subsequently, NSW Treasury has advised that this was only an illustrative assumption; and there is no basis for a write off while TAHE is valued on its current 'cost' approach<sup>29</sup>.

#### Why is TAHE's asset value relevant?

As a corporation, TAHE can only remit shareholder dividends after it has funded depreciation costs. If there is no write off for TAHE's asset value, the depreciation costs would be significantly higher leading to a greater quantum of access fees required to make TAHE commercial.

With circa double the depreciation costs that TAHE must fund with its operating cash flows, this sees TAHE increasingly 'trap' cash from the General Government Sector within TAHE as the retained cash balance increases over the forecast period.

#### Can this be resolved?

For completeness, we undertook a preliminary examination of TAHE's asset values, applying an 'income' approach. At NSW Treasury's request, the TAHE DCF has been excluded from the model<sup>30</sup>. Nonetheless, this suggested that TAHE's very high access and licence revenues see no write off available if TAHE moved from a 'cost' to an 'income' approach.

<sup>29</sup> Discussion held on 18/08/2020 with NSWT

<sup>30</sup> NSWT's request was made during the financial model workshop held on 15/09/2020.

The quantum of access fees required to make TAHE commercial appears to mean that no write off would be available on revaluation.

TAHE can at its sole discretion provide 'capital repayments' on an ad hoc basis – which subject to legal advice and TAHE's decisions, may provide a period basis to release these trapped funds.

In the absence of such ad hoc capital release payments, TAHE serves as an accelerating 'cash trap' – eroding the fiscal benefit further.

#### Access fees within regulatory compliance

The NSW Rail Access Undertaking sees IPART regulate third party access fees, determining a price 'floor' and 'ceiling' between which negotiations with access seekers occur.

We have applied price assumptions as requested by TAHE and NSW Treasury<sup>31</sup>; which see

- Access fees commence at \$0.00 for public rail operators in FY21.
- Access fees rise to \$700m for public rail operators in FY22.
- Thereafter access fees lift to reach TAHE's assumed ROE requirement in; however, access fees are capped at the ceiling price.

It is important to note that the above access fees are <u>net of maintenance and overhead costs</u>. For the purposes of testing IPART's compliance, the above access fees must be grossed up by maintenance and overhead costs; this grossed up figure must be within the IPART floor and ceiling. The below figure displays grossed up access fees and where it lies in relation to IPART's bounds.

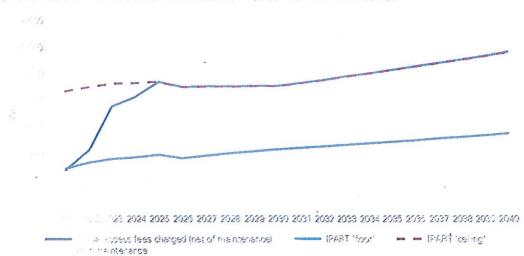


Figure 19. Scenario 1 (KPING's preferred assumptions) - Access fees within IPART pounds

#### Key observations:

- Grossed up access charges are below IPART's 'floor' by \$0.1bn in FY21; making TAHE non-compliant in this period.
- From FY22 onwards, grossed up access charges are within the bounds of IPART's 'floor' and 'ceiling'.
- From FY26 onwards, TAHE does not achieve its target ROE due to the ceiling price cap.

<sup>&</sup>lt;sup>31</sup> Assumptions discussed at numerous meetings with NSW Treasury, including on 14/08/2020, 18/08/2020, 20/08/2020, 15/09/2020, 23/09/2020 and 02/10/2020.

#### Sensitive: NSW Cabinet

The KPMG TAHE Financial Model is constructed to determine the minimum commercial revenue TAHE must earn in order to achieve a target ROE. This creates an obvious relationship between regulated access fees on the one hand and TAHE's unregulated licence fees on the other.

For example, if licence fees were suppressed, access fees would need to increase, potentially beyond the ceiling price.

This scenario sees TAHE reaching a net profit after tax position in FY25. In the years prior to this, TAHE is at a net loss after tax position; starting at (\$1.5bn) in FY21 moving to (\$0.9bn) by FY24. TAHE begins to pay dividends from FY25 to meet its target ROE and amounts increase over time in line with NPAT.

TAHE retains a healthy cash balance; funded by equity injections and significant access and licence fee payments from operators which ramp up to some \$3.9bn by FY27.

Similar to Scenario 1 (KPMG's preferred assumptions) above, we have described the model across three aspects to provide detailed insight; being revenue, dividends and access fees. Detailed analysis and discussion in relation to these categories is outlined in the sections below.

#### Revenue

Earning a commercial revenue is integral to sustaining TAHE's for-profit PNFC and 'for profit' status into the long-term. Scenario 2 (NSW Treasury's preferred assumptions) considers two key sources of commercial revenue; access fees and licence fees.

While TAHE contemplates potential future returns from commercial activities and development, we are advised the detail is to be developed and agreed with Voting Shareholders. For the purpose of the financial model we assume any benefits will be beyond five years and therefore, are not relevant to this assessment.

Under the applied transitional plan which phases in access and licence fees, TAHE does not earn a net profit after tax until FY25 but consistently sustains a net profit after tax position thereafter:

- In FY21, no access or licence fees are earned, resulting in an NPAT of (\$1.5bn).
- In FY22, no licence fees are earned but \$700m of access fees are earned, resulting in an NPAT of (\$0.9bn).
- In FY23, \$0.2bn of licence fees and \$700m of access fees are earned, resulting in an NPAT of (\$0.8bn).
- In FY24, \$0.2bn of licence fees and \$700m of access fees are earned, resulting in an NPAT of (\$0.9bn).
- From FY25 onwards, TAHE consistently maintains a net profit after tax position.

Over the initial five years where TAHE is in a net loss after tax position, tax losses are accumulated and then subsequently utilised from FY25 to FY30. TAHE becomes liable for tax equivalent payments from FY31 after all previously accumulated tax losses are utilised.

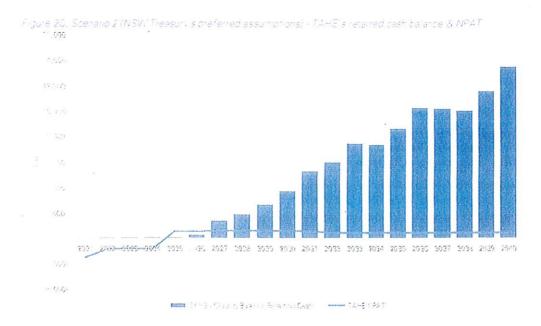
#### **Dividends**

The 2015 ABS determination notes an expectation of dividends on all assets transferred to TAHE via equity. However, detailed modelling reveals that TAHE serves to 'trap' a large portion of its access and licence fee revenues, because TAHE's asset value is much higher than the 50 per cent write-off assumed in NSW Treasury's May 2020 financial model.

Modelling of Scenario 2 (NSW Treasury's preferred assumptions) indicate the following:

- No dividends are paid in the first four years (FY21-FY24).
- TAHE begins paying dividends in FY25 of \$0.4bn.
- The dividends paid by TAHE remain stagnant at approximately \$0.4bn for the next years in line with a target ROE of 1.31 per cent.

As a corporation, TAHE can only pay dividends out of NPAT, after non-cash depreciation costs are accounted for. Figure below shows the accumulation of retained cash in TAHE under this scenario



#### Access fees within regulatory compliance

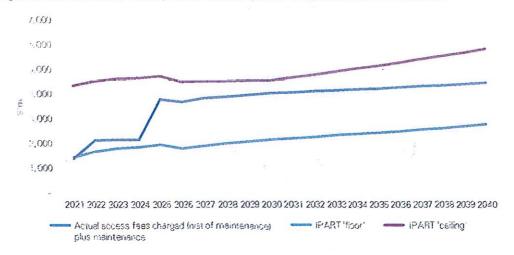
The NSW Rail Access Undertaking sees IPART regulate third party access fees, determining a price 'floor' and 'ceiling' between which negotiations with access seekers occur.

Applying Scenario 2 (NSW Treasury's preferred assumptions) price assumptions results in:

- Access fees commencing at \$0.00 for public rail operators in FY21 and \$700m for FY22 to FY24.
- Thereafter access fees lift to reach TAHE's assumed ROE of 1.31%.

It is important to note that the above access fees are <u>net of maintenance and overhead costs</u>. For the purposes of testing IPART's compliance, the above access fees must be grossed up by maintenance and overhead costs; this grossed up figure must be within the IPART floor and ceiling. The below figure displays grossed up access fees and where it lies in relation to IPART's bounds.

Figure 21: Scenario 2 (NSW Treasury's preferred assumptions) - Access fees within IPART bounds



#### Sensitive: NSW Cabinet

#### Key observations:

- Grossed up access charges are below IPART's 'floor' by \$0.1bn in FY21; making TAHE non-compliant in this period.
- From FY22 onwards, grossed up access charges are within the bounds of IPART's 'floor' and 'ceiling'.

The KPMG TAHE Financial Model is constructed to determine the minimum commercial revenue TAHE must earn in order to achieve a target ROE. This creates an obvious relationship between regulated access fees on the one hand and TAHE's unregulated licence fees on the other.

For example, if licence fees were suppressed, access fees would need to increase, potentially beyond the ceiling price.

#### Entity level impacts to TiNSW

TAHE's long-term operating model has a number of financial impacts on TfNSW as a standalone entity, who now need to reconsider the allocations of their annual appropriation package from NSW Treasury.

Under both scenarios, the entity level impact to TfNSW is the <u>same</u> and has been described in the section

Detailed analysis on two key areas will be discussed in sections below; operating portion of TOTEX funding and revenue reallocations from Sydney Trains to TAHE.

Both TAHE scenarios see TfNSW funding the operational portion of TOTEX on TAHE's assets to the public operators initially; operational portion of TOTEX is then subsequently netted off against access and licence fees TAHE receives from the public operators.

TfNSW will need to continue allocating its existing budgeted appropriations to fund the operating portion of TOTEX; approximately \$1.2bn annually.

TAHE funds the capital portion of TOTEX directly through its equity injections and therefore has no impact on TfNSW at the entity level.

The transfer of all RailCorp 'heavy' rail assets to TAHE has also meant that the revenue streams associated with those assets, previously residing with Sydney Trains, are now transferred into TAHE.

Below are the relevant revenue streams which have been transferred:

- Airport Link 'ALC' revenue a payment previously directed by the Transport Secretary to be paid by RailCorp to Sydney Trains in relation to the Airport Link line is reversed and no longer paid.
- Advertising revenue revenue earned from traditional billboards along rail corridors, digital screens
  installed in stations and printed advertisements inside passenger rolling stock; all relating to assets that
  sit on TAHE's balance sheet.
- Vending machine revenue revenue earned from vending machines at stations now belonging to TAHE.

The transfer of these revenue streams has resulted in a larger deficit in Sydney Trains and the need for TfNSW to allocate more appropriations in order to balance the operator to breakeven. Cumulative revenue from these streams is approximately \$100m p.a. and \$1 bn over the next 10 years.

It is important to note that both Sydney Trains and NSW Trains have historically balanced to a cash breakeven point with budgeted appropriations from TfNSW and existing cash balances in each entity.

COVID-19 resulted in significantly reduced farebox revenue over the next two years however additional appropriations have already been funded by NSW Treasury to make up the shortfall. As such, the bottom-line budget impact presented by the TAHE Financial Model does not include any COVID-19 related impacts as an incremental cost of having TAHE as a commercial SOC.

# Net fiscal impacts - comparison to June Cabinet Submission estimates

The KPMG TAHE Financial Model shows a material deterioration in the net fiscal benefits offered by TAHE. As noted elsewhere, this reflects that the detailed consideration now factors in TAHE's fiscal costs, as well as its benefits.

## us - no 1: KPIVIG's preferred assumptions

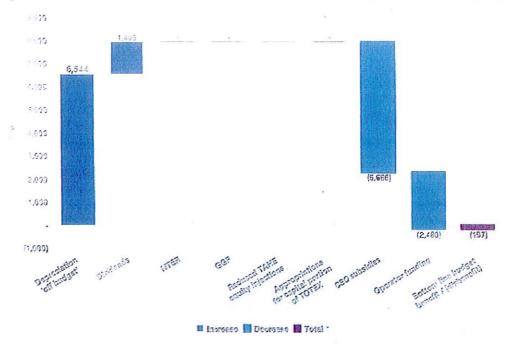
Using the same assumption that underpinned the estimates in the June Cabinet Submission shows TAHE would provide a \$1.2bn fiscal reporting benefit in FY21. This reflects the minimal fiscal costs given access and licence fees have not switched on yet. As access and licence fees begin to switch on in FY22, the cumulative four-year budget benefit decreases to a total of (\$0.2bn); showing the fundamental relationship between access fees and the deterioration in projected performance.

Table 18: Scenario 1 (KPMG's preferred assumptions) versus June Cabinet Submission estimates

	FY21 (Budget Year)	Forward estimates
Comparator: June Cabinet Submission	\$1.5bn	\$6.5bn
Detailed model - Scenario 1	(\$0.3bn)	(\$6.7bn)
Budget benefit / (disbenefit)	S1.2bn	(\$0.2bn)

A further breakdown of all fiscal benefits and costs considered is displayed in Figure 22 below; highlighting CSO subsidies required for access and licence fees to be the most significant contributor to budget deterioration.

Figure 22. Scenario 1 thPMG's preferred assumptional versus June Cabinet Submission estimates - Forward Years



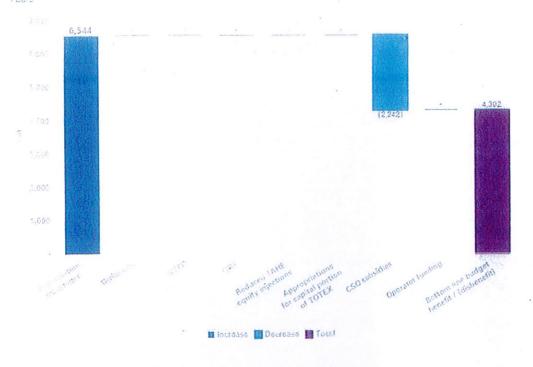
Using the same assumption that underpinned the estimates in the June Cabinet Submission shows TAHE would provide a \$1.5bn fiscal reporting benefit in FY21. This reflects the minimal fiscal costs given access and licence fees have not switched on yet. As access and licence fees begin to switch on in FY22, the cumulative four-year budget benefit increases to a total of \$4.3bn.

Table 19 Scenario 2 (NSW Treasury's preferred assumptions) versus June Cabinet Submission estimates

	FY21 (Budget Year)	Forward estimates
Comparator: June Cabinet Submission	\$1.5bn	\$6.5bn
Detailed model - Scenario 2	\$0.0bn	\$2.2bn
Budget benefit / (disbenefit)	\$1.5bn	\$4.3bn

A further breakdown of all fiscal benefits and costs considered is displayed in Figure 23 below; highlighting CSO subsidies required for access and licence fees to be the most significant contributor to budget deterioration.

Figure 23: Scenario 2 (NSW Treasury's preferred assumptions) versus June Cabinet Submission estimates- Forward Years



# Section 3: Transition Plan

#### Sensitive: NSW Cabinet

# TAHE operating model Staged transition

The long-term operating model contemplates how and what TAHE will do, once it is fully operational. It is a key consideration for Cabinet to consider, reflecting the need to decide the limits of TAHE's operations granted by the Minister for Transport, under its operating licence.<sup>32</sup>

Importantly, the SER safety advice is based on the measured transfer of functions to TAHE to allow it to progressively 'switch on' over a safe and achievable timeframe. This notes the range of near-term and complex tasks it faces to establish its operating policies and procedures; and to negotiate the constellation of commercial, legal, regulatory and other agreements and arrangements needed to achieve its baseline function of charging access and license fees to public rail operators.

For clarity, the long-term operating model assumes:

- The current operating license remains in force until 1 July 2021;
- A review of the operating licence will be commissioned by the Minister for Transport and Roads in or around January 2021;
- A new operating licence from July 2021 is assumed to be in place; and
- A phased implementation of TAHE functions across regulated and non-regulated assets to mitigate operational and safety risks.

## Immediate next steps for TAHE:

The most pressing priority for TAHE is an agreed Statement of Corporate Intent; which will guide TAHE's ensuing commercial and other decisions as it moves to active operations. The activities below highlight the relevant near-term priorities necessary to support TAHE's core business:

- Establish a suitably qualified workforce estimated at between 31-41 FTE personnel to support TAHE's long-term operating model.<sup>33</sup>
- Develop an Access Pricing policy to guide negotiation with public rail operators.
- Plan for negotiation of new rail service contracts from 1 July 2021, which include access arrangements for the public rail operators.
- Prepare for the impending review of the NSWRAU and compliance thereof.
- Negotiate and agree the terms, policies and practices for capital project approval.
- · Appoint and negotiate terms with a network maintainer.
- Establish and rapidly implement suitable safety assurance policies and procedures for management and maintenance of TAHE's assets.
- Establish and implement an asset management and assurance framework for TAHE's assets that are not subject to TfNSW's assurance procedures.
- Develop and agree with key stakeholders, the process and protocols for TAHE to execute its role of authorising the funding of maintenance.
- Identify and enter into commercial, arm's length arrangements for the provision of all corporate services provide by service providers on TAHE's behalf.

<sup>32</sup> Section 13, TAA 1988 (NSW)

<sup>&</sup>lt;sup>33</sup> TfNSW Business Definition Report (BCG) and consults with TAHE on 03/09/2020 and 11/09/2020; P&C on 07/09/2020 and 09/09/2020; Safety & AM on 03/09/2020; and 09/09/2020 and CS on 09/09/2020 and 07/09/2020.

#### Key phases include:

- Immediate: Organisation setup: Consisting of corporate governance, workforce transition and technology transition, this phase is contemplated across FY21.
- FY21: Ramp up of core functions: As TAHE develops its policies and recruits qualified personnel, the
  long-term operating model contemplates the corporation progressively assuming control over its core
  activities, such as resolving its pricing and price regulation strategies and negotiating commercial armslength agreements with access seekers. Noting that new Rail Services Contracts must be executed by 1
  July 2021, this and accompanying pricing and access arrangements will be a primary and urgent focus
  for TAHE
- Expected FY 21: Regulatory review of the NSW RAU: The NSW Government anticipates requesting an IPART review of the NSWRAU in FY21. Noting that this establishes the floor and ceiling price that can be charged by TAHE and noting the complexity of regulatory economics; this review process is fundamental to TAHE's revenues and operations.
- FY21-26: Core operations: The operating model contemplates that TAHE will be limited to
  implementing its revenues via access and license fees; and acquitting its requirements to approve
  capital and operating expenditures and manage the corporations core safety, financial and other
  requirements. Noting the sophisticated skills developed within TfNSW and the large programme of
  ISDs, commuter car parks and other projects underway or planned, the long-term operating model
  contemplates TAHE's operating licence restricting the corporation to appointing TfNSW to act on its
  behalf in respect of property developments and station upgrades, until the end of the next operating
  licence.

A breakdown of the key activities and timing for each action is provided in Table 20. This transition plan is based on both extensive consultation, and information generated by TAHE's commercial advisors.

Table 20: Detailed overview of key transitional plan activities

Action	Key activities	Timing
Corporate gove	rnance	
TAHE Board and Management planning	<ul> <li>Develop TAHE Board procedures</li> <li>Appoint TAHE executives and agree KPIs (operational and financial)</li> <li>Develop detailed business plan (incl. detailed projections and targets, competition and market analysis, and improvement plans)</li> <li>Collaborate with Portfolio Minister to develop the initial Statement of Expectations</li> </ul>	Start: Immediate  Duration: 6 months
Develop internal policies and frameworks	<ul> <li>Agree performance monitoring and reporting processes</li> <li>Develop internal and external audit mechanisms and controls</li> </ul>	Start: Immediate  Duration: 6 months
Statement of Corporate Intent (SCI)	<ul> <li>TAHE Board to draft SCI which outlines TAHE's objectives, key activities, KPIs, access pricing strategy and accounting policies.</li> <li>Confirm rate of return and methodology, across regulated and unregulated asset classes</li> <li>Consult with shareholding ministers on the draft SCI, including agreement on:         <ul> <li>Target Capital Structure</li> </ul> </li> </ul>	Start: Immediate  Duration: 3 months  Assume SCI content outlines proposed timeline to confirming
	<ul> <li>Course of action for credit rating, if applicable</li> <li>Shareholding ministers approve SCI</li> </ul>	key outputs

letion	Key activities	Timing
	Finalise balance sheet review	
	Agree debt and equity structure	Start: Mid FY21*
Confirm key	<ul> <li>Confirm if credit rating outlook is to be reviewed based on Target Capital Structure</li> </ul>	Duration: 12 months
orporate tructures	<ul> <li>Confirm accounting practices and rules to be applied beyond 1 July 2020</li> </ul>	*Requires tax specialist to be hired
	<ul> <li>Confirm tax structure and assess NTER and other tax liabilities</li> </ul>	
	<ul> <li>Confirm asset valuation basis, depreciation, substance of fees (accounting treatment) and dividend policies</li> </ul>	
	Create financial control systems and processes	
Confirm Inancial	<ul> <li>Clarify delegation of responsibilities to TfNSW, operators and maintainers</li> </ul>	Start: Immediate
ontrol and	<ul> <li>Confirm funding and financing sources and uses</li> </ul>	Duration: 10 months
lelegations	<ul> <li>Transfer relevant income to TAHE P&amp;L</li> <li>Transfer advertising income from Sydney Trains</li> </ul>	
	- Transfer Airport Link net income from Sydney Trains	
<b>Vorkforce transit</b>	(01)	anstruction de la company
	In depth organisational and resourcing analysis	
	Finalise outsourcing arrangements for support services	5.404
Develop and Igree	<ul> <li>Identify where internal capabilities from TfNSW can be leveraged, and the appropriate resourcing arrangement for this (i.e. secondment or</li> </ul>	Start: FY21
organisational	direct employ)	Duration: 3 – 4 months
structure	<ul> <li>Reach agreement to transfer relevant TfNSW staff from cluster agencies</li> </ul>	months
	Agree budget and service fee arrangements	
	Advertise for roles	0
Create and fill	<ul> <li>Migrate relevant existing TfNSW staff from cluster</li> </ul>	Start: Mid FY21
new roles	Prepare employment contracts	<b>Duration</b> : 6 months
_, -, -, -, -, -, -, -, -, -, -, -, -, -,	Transfer superannuation and workers compensation liabilities	
Technology Tran	sition	
Define	Confirm technology and systems to be leveraged from TfNSW and	
technology,	identify gaps	Start: Mid FY21
data and	<ul> <li>E.g. Asset management systems, SAP, invoicing/financial management</li> </ul>	<b>Duration</b> : 2 months
systems need	Confirm extent of data needed from operators/ TfNSW	
Systems	107 · 11 TAINW	Start: Mid FY21
procurement	ICT services agreements with TfNSW	Duration: 6 - 12
and integration	Data architecture	months
	ntion	
Contract prepara		
Review	Undertake scan of all existing relevant contractual arrangements	Start: Immediate
A CONTRACTOR OF THE PARTY OF TH	<ul> <li>Undertake scan of all existing relevant contractual arrangements</li> <li>Identify areas of required changes for each contract (e.g. novation from RailCorp to TAHE)</li> </ul>	
Review existing contractual	<ul> <li>Identify areas of required changes for each contract (e.g. novation</li> </ul>	Start: Immediate  Duration: 3 months  Start: Immediate*

Action	Key activities	Timing
	<ul> <li>I&amp;P: Project delivery</li> <li>SER: 2<sup>nd</sup> level Assurance</li> <li>CST: Regulatory support (IPART engagement)</li> </ul>	Duration: 3 – 6 months
	<ul> <li>GS/ ROM: Contract management</li> <li>CS / P&amp;C: Other support services</li> </ul>	*TAHE currently consulting with I&P
RSC with Sydney Trains and NSW Trains	<ul> <li>Prepare terms sheet</li> <li>Re-negotiate RSC terms including obligations, access arrangements, maintenance (if applicable), funding and other requirements</li> <li>Execute RSC</li> </ul>	Start: Immediate*  Duration: 9 months *In conjunction with access arrangements
Maintenance agreements	<ul> <li>Prepare terms sheet</li> <li>Re-negotiate terms (price, terms, obligations)</li> <li>Appoint maintainer</li> <li>Confirm plan to develop asset management and assurance frameworks for non-specialised assets, such as car parks.</li> </ul>	Start: Immediate  Duration: 10 months
Licence agreements	<ul> <li>Prepare terms sheet</li> <li>Re-negotiate terms (price, terms, obligations)</li> <li>Appoint maintainer</li> </ul>	Start: Immediate  Duration: 10 months
Business plannin		
Establish access arrangement	<ul> <li>Finalise TAI-IE position on access arrangements         <ul> <li>Review existing RAU arrangements</li> <li>Obtain advice to determine the impact of the RAU on the assumed cost and timing of the commencement of asset charges</li> <li>Draft proposed changes to access arrangements policy and strategy</li> </ul> </li> <li>Engage with IPART on access arrangements         <ul> <li>Participate in review of 2009 NSWRAU policy</li> </ul> </li> </ul> <li>Confirm whether TfNSW submits information for IPART review process on TAHE's behalf</li> <li>Negotiate terms with ST and third-party access seekers</li> <li>Resolve outstanding issues (e.g. special events compensation "unders and overs")</li>	Start: Immediate  Duration: 10 months  *To be done in conjunction with RSC before 1 July 2020
Develop commercial	<ul> <li>Identify in detail additional revenue streams and commercial opportunities</li> <li>Agree risk profile and appetite</li> <li>Develop investment prioritisation policy</li> </ul>	Start: FY22* Duration: 12 months
strategy	<ul> <li>Contemplate current vs future asset portfolio structures (incl. areas of value potential)</li> <li>Explore sale and leaseback on assets</li> </ul>	*Requires specialist workforce
Develop asset assurance frameworks	<ul> <li>Develop asset improvement plan</li> <li>Define assurance monitoring and reporting requirements</li> <li>Define the non-attested asset base</li> <li>Agree delegation of roles and responsibilities between TfNSW, operators and maintainers</li> </ul>	Start: FY22 Duration: 12 months
Asset management planning	<ul> <li>Develop relevant AMPs (e.g. TAHE SAMP, Non-operational asset AMP)</li> <li>Align to assurance framework</li> </ul>	Start: FY22 Duration: 12 month

Action	Key activities	Timing
Ongoing operat	tions	(2) 1400 1400 1400
	Identify and select new sites for telco macro and micro cells	
Execute	Surplus real estate disposals	Start: FY23
shortlisted	Package and sell new macro towers	Duration: 12+
priorities 34	Rental portfolio enhancement monitoring	months
	<ul> <li>Sell or leaseback assets, if applicable</li> </ul>	
Property		Start: FY25
development planning	Explore property development pipeline	<b>Duration</b> : 12 – 18
	Planning for non-station site redevelopment	months

# TAHE's Operating Licence

Formed as a statutory SOC, TAHE requires an enabling operating licence/s, which permit its activities. The operating licence is determined by the Minister for Transport & Roads.

TAHE's inaugural operating licence was granted to govern its first year of operations, to 1 July 2021; and will be reviewed from 1 January next to develop TAHE's first operational operating licence.

It is attached at Appendix 10.

The long-term operating model and supporting independent safety advice from SER is predicated on an orderly transition of functions and accountabilities to TAHE.

Noting the complex interfaces between TAHE and other elements of the transport ecosystem, this staged and orderly transition is important to ensure that functions are transferred only when corresponding organisational capability exists within TAHE to manage and administer each function.

Detailed consideration of the form and structure of TAHE's operating licence/s will occur in the next phase of work on TAHE, but the long-term operating model advice broadly assumes that TAHE will be progressively granted sequential operating licences; reflecting both its readiness and the sequential order of priorities determined by the TAHE Board, SCI and other factors outlined below.

For example, TAHE will assume accountability for non-specialised assets. TAHE must implement an adequate asset safety and assurance framework in relation to the TAHE assets.

Noting the safety considerations and overall Transition Plan, the indicative list below of functions (Schedule 1) should be considered for incorporation into to the revised Operating Licence, and under what terms (Schedule 2). TfNSW, in consultation with TAHE and other government stakeholders, will lead the review of the current Operating Licence and prepare the revised Operating Licence for Ministerial approval.

# Schedule 1 - initial view on new TAHE functions post 1 July 2021

- Negotiate access terms with public and private rail operators
- Renegotiate and execute the Rail Service Contracts
- Input to regulatory reviews, for example the proposed review of the NSW Rail Access Undertaking.
- Approve capital project materials related to TAHE assets
- Confirm plan to prepare asset management and applicable frameworks for non-specialised assets.
- Implement suitable safety and environment assurance frameworks for its specialised rail assets
- Endorse the level of maintenance funding

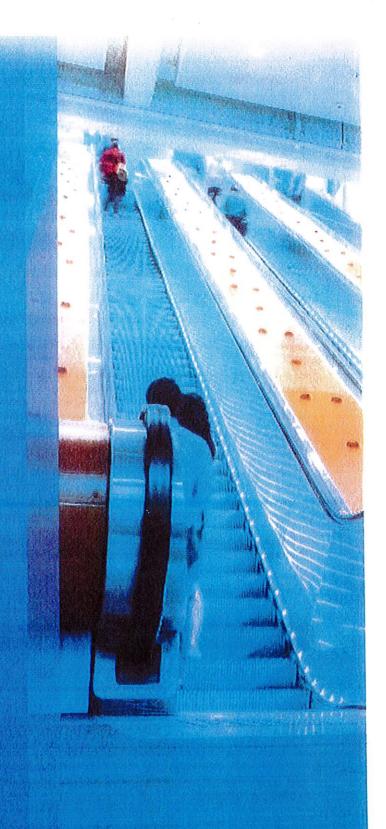
<sup>&</sup>lt;sup>34</sup> From the TAHE operating model update 230920, Boston Consulting Group (BCG)

Appoint maintainer

# Schedule 2 - Preliminary view on changes to the terms and conditions:

- Ongoing projects: The list of Cabinet approved projects will require updating, as new project have
  received investment approval to proceed. It is important that these inflight projects remain under
  delivery by TfNSW's specialised teams, until a point where TAHE has accrued internal capability.
  Appropriate safety and environment consideration and arrangement must be implemented for nonspecialised capital projects.
- Terms and agreements between TfNSW and TAHE need to be defined.
- Exclusions and limitations from the operating model defined, e.g.:
  - Commuter car parks, ISDs, station upgrades and property development;
  - Other commercial activities; and
  - Asset disposals.

Section 4:
Assessment
against Cabinet
objectives: Fiscal,
operational and
organisational



# Fiscal objectives assessment

## Background

The June 2020 Cabinet Submission outlined the negative fiscal impacts that would occur, should TAHE be unable to be sustained as a bona fide PNFC over time. At that time NSW Treasury estimated that the budget would deteriorate by \$1.8 billion in FY21, should TAHE return to the General Government Sector.

Accordingly, Cabinet endorsed three specific fiscal objectives within the overall TAHE objectives, requiring that TAHE:

- Meet accounting standard requirements by 1 July 2020.
- · Sustain the accounting treatment over time.
- Maintain PNFC classification from the ABS (for-profit TAHE, NFP for ST and NSWT).

## This is not accounting advice

As noted in the methodology, this section does not constitute accounting advice or opinion. No accounting opinion has been sought on the long-term operating model. Instead, we have sought to comply with the intent of the existing NSW Treasury accounting advice – and have sought detailed input from NSW Treasury officers across each stage of development, to ensure our work supports the fiscal objectives.

While not providing any accounting opinion, this section necessarily provides observations about issues raised in our work developing TAHE's long-term operating and detailed financial models.

These observations are intended to inform TfNSW's request for NSW Treasury to seek fresh accounting advice on TAHE, now that far more is understood about how it is intended to operate in practice 35.

#### Assessment

This section qualitatively assesses the ability of TAHE to meet the fiscal objectives tabled in the Joint Submission to Cabinet by NSW Treasury and TfNSW in late May 2020.

Table 21 outlines the fiscal objectives set by Cabinet and indicates, via a traffic light system, the likelihood of TAHE satisfying them.

Table 21: Traffic light analysis of fiscal objectives for TAHE long-term operating model

iscal objectives	Rating
Meet accounting standard requirements by 1 July 2020	
Sustain the accounting treatment over time	
Maintain PNFC classification from the ABS (for-profit TAHE, NFP for ST and NSWT)	

**Key:** *Green* = likely to meet the objective, *Amber* = potential to not meet the objective, *Red* = highly unlikely to meet the objective.

<sup>35</sup> See TAHE Working Group minutes, 18 September 2020

# 1. Does TAHE meet accounting standard requirements by 1 July 2020?

Likely.

NSW Treasury has advised that TAHE will meet NSWAO requirements for FY20.

# Can TAHE sustain the accounting treatment over time?

Potentially.

Treasury's advice is based on 1 July 2020 and did not consider a detailed operating model, which has not existed until this body of work.

NSW Treasury has provided accounting advice for TAHE across a range of relevant standards, including:

- AASB 10 consolidated financial statements.
- AASB 1059 service concessions arrangements.

We have provided a brief outline of our understanding of these below, applying them to the long-term operating model for TAHE. It is noted that KPMG are aware that managements have been through processes to validate accounting positions and to consult with the Audit Office. It is of KPMG's understanding that these have been accepted by the Audit Office as at 1 July 2020. The following observations are made for ongoing reviews of accounting positions.

#### 1. AASB 10 - Consolidated Financial Statements: periodically review

We understand that AASB 10 requires that an entity (the parent) that controls one or more other entities (subsidiaries), presents consolidated financial statements <sup>36</sup>. An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee <sup>37</sup>.

This means for example, that if TAHE were determined to be controlled by TfNSW, then TAHE and its assets would move from the PNFC and return to the Budget.

NSW Treasury's advice to 1 July 2020 holds that TAHE is no longer a controlled entity of TfNSW and will see little intervention from the general government sector.

With the long-term operating model developed, this materially updates the fact pattern available for accounting advice.

Accordingly, updated accounting advice should be sought to confirm the sustainability of the operating model over time.

#### 2. AASB 1059 - Service Concessions Arrangements: periodically review

The general premise for AASB 1059 is that an entity will disclose the assets that it controls over the period that it exerts control of those assets, regardless of legal ownership.

AASB 1059 was issued in 2017 and is due to commence from 1 July 2020, requiring grantors to recognise a service concession asset and, in most cases, a corresponding liability on the balance sheet.

Relevant NSW Treasury accounting advice to 1 July found that the arrangements are outside of the scope of AASB 1059 on the basis that the Rail Operators are not providing services on behalf of TfNSW given the provision of the relevant service is not within TfNSW's mandate, but rather the Operators are acting as the principal in delivering their own service delivery mandate <sup>38</sup>.

With the benefit of a developed long-term operating model, updated advice should be sought to confirm the sustainability of TAHE under these standards.

37 AASB 10

<sup>36</sup> AASB 10

<sup>33</sup> NSW Treasury Advice, NSW Rail Arrangements, AASB 1059 Assessment

#### 3. AASB 16 - Leases: advice needed

No specific assessment or advice was provided for with regard to AASB 16, which is the accounting standard that sets out the principles for the recognition, measurement, presentation and disclosure of leases, and defines lease agreements.

Our understanding of AASB 16 is that it follows the same general premise of AASB 1059 – that assets are recorded by the entity which exerts control over the relevant assets.

It follows that a similar risk arises in that if TfNSW is determined to have a right to control or direct the use of TAHE's assets given its ability to determine utilisation of the assets under the Rail Service Arrangements, then the assets and associated depreciation could potentially be transferred from the PNFC into the GGS.

Similarly, the updated long-term operating model should form the basis of advice on the risks associated with the introduction of AASB 16 and its application to the arrangements between TAHE and TfNSW.

# 3. Can TAHE maintain PNFC classification from the ABS (for-profit TAHE NFP for ST and NSWT)?

#### Potentially.

The NSW Cabinet's TAHE fiscal objectives require that the long-term operating model be capable of sustaining the PNCF status of TAHE; but also, that of Sydney Trains and NSW Trains – the public rail operators who are currently also characterised as Public Non-Financial Corporations.

The ABS under the General Finance Statistics (GFS) manual sets the criteria, definition and guidance for how all entities should be classified for all Government agencies nationally. Entities can be classified as General Government (GG), Public Non-Financial Entities (PNFC) and Public Financial Entities (PFE). These classification rules define how the State produces its public financial reporting.

The ABS advised the Government in 2012 of its intention to reclassify RailCorp to the GG sector because of concerns it did not meet the classification criteria for a PNFC.

On 6 May 2015, ERC approved the establishment of TAHE to operate as a commercial entity in the PNFC sector or alternatively, a 'for profit PNFC'.



#### What are the PNFC criteria?

The criteria for PNFC status are set out within the ABS 2015 publication 'Australian System of Government Finance Statistics: *Concepts, Sources and Methods' (ABS GFS Manual)*. A principles-based approach is applied when determining whether an entity satisfies PNFC criteria. PNFC classification requires all of the following:

- Limited GGS intervention;
- Determination that an entity is a market producer; and
- Confirmation of an entity being a separate institutional unit in its own right (which is assumed to exist and not explored).

The 'for-profit' status indicates that the government shareholder can expect a sufficient return, which supports treatment by the GGS of injections of equity into TAHE.

On 29 May 2015, the ABS granted RailCorp transitional commercial PNFC status in response to NSW Treasury's request for determination and information provided to the ABS.

In the request for determination, NSW Treasury advised the ABS that TAHE will:

own, finance, and maintainnai issaets in the comprising intrastructure above shall below land finack isignais, stations, rolling stockletic, and lease these assets out to commercial operators at commercial rates. <sup>22</sup>

The ABS advised TAHE is classified as a PNFC, but it should be informed of any changes to structure, operating environment of legislation. Some of the structural and operational information presented to the ABS in the request for determination includes:

- TAHE will be a separate institutional unit
- . TAHE will negotiate and enter into lease arrangements with government and private sector operators
- TAHE will adjust prices within IPART regulated bounds to react to market changes and movements
- TAHE will pay a rate of return to its shareholders in the form of dividends
- TAHE may receive future equity injections, but will provide a return on future investments
- NSW Government will not provide grants or subsidies to TAHE
- All other entities within the Transport Cluster will be unaffected, apart from a minimal increase in grants and subsidies to Sydney Trains and NSW Trains.

On this basis, the ABS agreed to the transitional classification of TAHE and the rail operators as for profit and not for profit PNFCs, respectively; but noted that entities may be reclassified in the future should TAHE's operating environment or structure change

Specifically, the ABS requested to be informed of the level of grant and subsidy funding that would be provided to the Public Rail Operators under the long-term TAHE model.

Upon providing its transitional classification for TAHE, the ABS requested that entities may be reclassified in the future and the ABS should be informed of any changes to TAHE's structure, operating environment or other circumstances. The ABS specifically requested that the level of Government transfers to the Public Operators be communicated once known, to confirm whether there is any change to the classification of these entities <sup>40</sup>.

NSW Treasury's request for determination to the ABS stated TAHE would own, finance and maintain rail assets in the comprising infrastructure above and below land (track, signals, stations, rolling stock etc) and lease these assets out to commercial operators at commercial rates.

The long-term TAHE operating model now reflects TAHE's high-level functions to:

- Own all formerly RailCorp 'heavy' rail assets, including trains, tracks, property and other infrastructure
- Authorise funding and investment decisions for new capital projects within TAHE's portfolio
- Provide strategic direction, assurance and funding endorsement for maintenance, but not to carry out maintenance activities that require Accreditation under RNSL
- Enter into Access Agreements to provide access to its regulated assets, negotiating pricing arrangements and appointing TfNSW to negotiate and develop non-price elements of agreements
- Enter into and negotiate commercial Licence Arrangements for use of its unregulated assets
- Develop an assurance framework and asset management policy that will enable TAHE's Board to attest
  to the safety, management and performance of its assets under ASM standards and NSW Treasury
  Asset Management Policy.

It is therefore expected that the ABS will reassess or confirm the adequate classification of TAHE and the Rail Operators once arrangements to support the long-term TAHE operating model are agreed.

<sup>39</sup> ABS Determination, 2015

<sup>40</sup> ABS determination

#### Limited Government Intervention:

A criterion to maintain PNFC classification is to demonstrate 'limited Government intervention' which in this context is partly analogous to the accounting concept of 'control' discussed above.

This means that the above risk for maintaining accounting standards is also applicable for TAHE to maintain its PNFC status and requires limited intervention by TfNSW in directing TAHE's relevant activities.

This is also applicable to the Rail Operators, both currently subject to direction by the TfNSW Secretary by virtue of S3G of the TAA. TfNSW stakeholders indicated the TfNSW Secretary may cede S3G powers to the executive level within TfNSW to facilitate greater levels of integration in line with implementation of Evolving Transport.

The public rail operators are subject to S3G of the TAA, which NSW Treasury's accounting advice notes as:

"The power conferred (commonly referred to as section 3G powers of direction) is taken to provide TiNSW with relevant power to result in control over the public transport appares for accounting plumpers."

#### TAHE's for profit status and subsidies to Rail Operators:

TAHE is envisaged to provide a return to its shareholders and commence issuing dividends by FY23, with the predominant source of revenue arising through charges to the Public Rail Operators (\$2.0 FY23).

Given the Public Operators currently do not have sufficient revenue to cover existing operational expenses and incurred a deficit of \$1.5bn in FY20, NSW Treasury has advised that the additional access charges will be funded by way of direct subsidies to the Rail Operators.

The TAHE financial model indicates these will be in the order of \$2.4bn in FY24.

Given the risks outlined above, there is a risk that TAHE and the Rail Operators may not able to maintain their PNFC designation.

## Organisational and Operational objectives assessment

This section applies a qualitative assessment against Cabinet's organisational and operational objectives.

Figure 24: Summary Assessment

Organisational objectives	Rating
Supports 'Evolving Transport' and long-term operating blueprint	
Improves management of assets, commerciality and transparency of the use of public funds	0
Facilitate the integration of networks, services and project planning, across modes and with a customer focus	
Allow future reform to rail service delivery models	
Account for TAHE Board's duties and corporate objectives	
Operational objectives	Rating
Maintain and enhance safe network operations	
Create clear, logical operational accountabilities between TAHE, TfNSW and rail service operators	0

**Key:** Green = likely to meet the objective, Amber = potential to not meet the objective, Red = highly unlikely to meet the objective.

#### 1. Does TAHE support Evolving Transport?

Highly unlikely.

The Evolving Transport organisational restructure is fundamentally premised on the abolition of modal agencies. This reform reflects global trends in transport service delivery whereby mode specific agencies cede to customer journey-focused multi-modal structures.

The recent abolition of RMS is an example of this overall policy trend

In this way, the creation of an independent SOC with control over rail infrastructure cannot be considered to support this objective.

2. Does TAHE support a long-term model that improves management of assets, commerciality and transparency of the use of public funds?

Potentially.

TAHE offers transparency benefits, requiring regulated access fees, funding for whole of life costs, overlaid by enhanced reporting overseen by professional independent directors.

However, this sees disbenefits in meeting Cabinet's objective.

The first disbenefit is that the corporatisation of TAHE and thereby, making explicit costs to rail which may not be routinely funded or accounted for in other modes or budget sectors. Making rail relatively more expensive can be considered to be a relative disbenefit over time to a mode that already suffers from high operating costs.

The requirement to charge a profit in an inherently unprofitable rail sector adds further cost burdens to rail projects that are not faced by other priorities.

A further disbenefit arises through the rigidity of TAHE's structure accounts. A key aspect of the move away from modal-specific entities has been the intention to bring a portfolio approach to project contingency management; and to allow maintenance to be prioritised according to need, across modes. Neither of these are possible under the long-term operating model, noting that TAHE is a regulated SOC with statutory and fiduciary requirements over its use of funds.

A final disbenefit accrues via the much higher than anticipated depreciation costs. As noted in the report, prior considerations assumed TAHE's asset value would be written down by half. Without this write down, TAHE funds much higher depreciation costs, seeing substantial cash 'trapped' within the entity – because dividends can only be paid from NPAT.

NSW Treasury feedback has identified this as a benefit, explaining it creates the opportunity for TAHE to invest in its own capital projects. In practice, this is likely to diminish the overall quantum of transport capital funding available and see this money 'prequalified' to rail projects; repeating prior experience of mode-specific agencies and corporations.

On balance, we consider the benefits assumed from increased transparency are outweighed by the disbenefits posed through higher relative costs imposed on rail projects and the sequestration of trapped TAHE revenues for rail projects.

3. Does TAHE facilitate the integration of networks, services and project planning, across modes and with a customer focus?

Highly unlikely.

TAHE is an independent, mode specific agency. It is unlikely to naturally result in integration, noting the divergent interests and incentives between a for profit corporation and public service transport providers.

The operating model seeks to rectify these through the contemplation of TAHE's appointment of TfNSW to perform key tasks, such as business case development.

In practice, TAHE does not have a relationship with the customer and noting the limited contribution of passenger revenue to the operators, has little commercial incentive for regard to rail users.

4. Does TAHE allow future reform to rail service delivery models?

Likely.

5 Does TAHE account for TAHE Board's duties and corporate objectives

Likely

The operating model seeks to allocate the TAHE board with the ordinary functions and powers typical of a SOC

6 Does TAHE maintain and enhance safe network operations?

Likely subject to an approved detailed transition plan.

Based on the operating model and transition plan, once signed off by both TAHE and TfNSW, SER has advised this would be expected to move to a 'green' status assuming an orderly, considered and informed transition. Key implementation considerations are as follow:

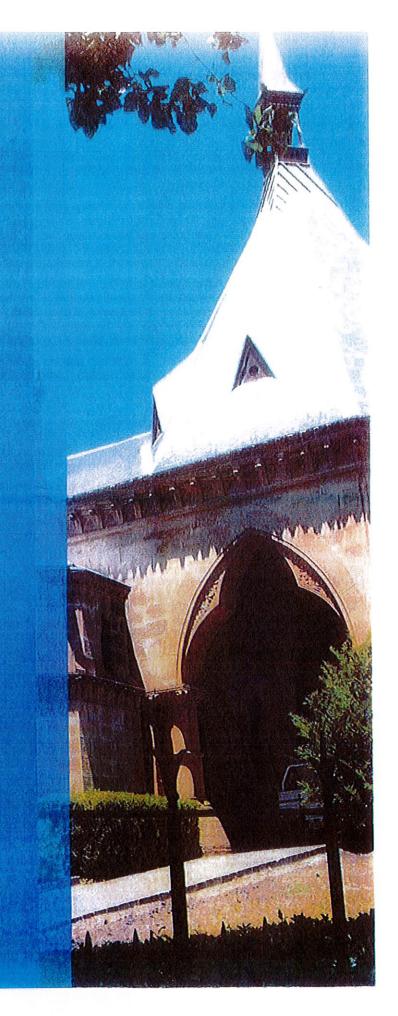
- Phased implementation over a number of years, aligns to asset management and safety approach, noting that heavy rail assets operate in a regulated environment with Sydney Trains and NSW Trains delivering approx. 420 million trips are taken annually (pre Covid);
- The asset management and safety approach is based on implementation of three lines of assurance, requiring TAHE and the Board to build capability and capacity;
- Substantial program of work required to manage implementation of revised governance, agreements and interfaces;
- Change management approach will be critical to ensure alignment to broader Transport reform
  objectives. Taking a whole of transport view of risk identification and mitigation will be critical in the
  change process; and
- Interfaces across five entities (TAHE, TfNSW, Sydney Trains, NSW Trains, CRN O&M) needs to be
  considered and also take into consideration revised operating environment, including award of new CRN
  contract in early 2021, with new O&M to begin operations in early 2022. Shared and individual
  accountabilities and responsibilities are understood and discharged.
- 7 Does TAHE create clear, logical operational accountabilities between TAHE, TfNSW and rail service operators

Potentially.

The TAHE long-term operating model has sought to introduce the most logical accountabilities possible, within the complexity of structural separations between funding and delivery of rail capital and operations.

Further work will be required to resolve in detail the range of transactions and interfaces that will inevitably be encountered as TAHE moves toward full operations.

Section 5: Conclusion and Next Steps



### Conclusion

This report has developed TAHE's long-term operating model to meet Cabinet's fiscal, organisational and operational objectives. Where inconsistency has arisen between objectives, we have sought to prioritise safety and then fiscal objectives over others; reflecting their binary nature.

The long-term operating model sees TAHE as an independent, mature corporation that exists to profitably meet its objectives as the owner of the State's regulated rail network, unregulated rail assets and substantial adjacent non-operational land holdings. Further, the long-term operating model contemplates TAHE with independent control over access and licence arrangements for rail assets; operational and non-operational capital projects; endorsement of maintenance level; and finance and funding.

This report has included financial modelling and detailed analysis, derived from the 'KPMG TAHE Financial Model'. The detailed model shows a significant erosion in the estimated net fiscal benefits offered by TAHE over the forward estimates and the 10-year evaluation period. Importantly, NSW Treasury's preferred TAHE scenario has evolved over the course of the financial modelling; and now sees some limited but important areas of divergence between KPMG's preferred assumptions, and those desired by Treasury.

The long-term operating model was assessed against Cabinet objectives to determine the extent to which TAHE can be successfully implemented while achieving the required objectives.

#### Next steps

TAHE's creation marks a material change in the shape of transport administration in NSW – and will see the most substantial reordering of functions in rail, since the structural reforms in the 1990s.

The complexity of operation and the overlays of economic, safety, environmental, fiscal and corporate requirements mean TAHE will require a staged transition of duties, over time.

We have outlined a draft transition plan, designed to allow TAHE to focus on establishing its core contractual and commercial relations, found in **Section 3**.

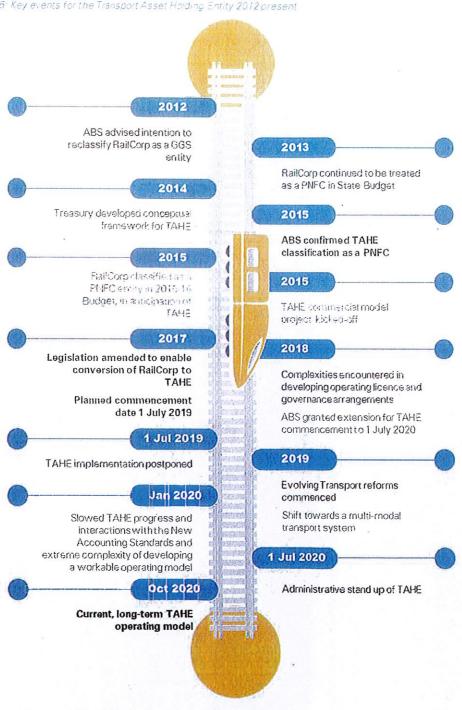


Appendix

### Appendix 1: About TAHE

The Transport Asset Holding Entity (TAHE) came into legal existence on 1 July 2020; but has been under consideration and development for more than five years. Figure 25 below outlines key events relevant to TAHE - from 2012 to now.

Figure 26: Key events for the Transport Asset Holding Entity 2012 present



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NSW rail assets have been classified on the State's PNFC balance sheet since 1996; <sup>41</sup> with corporatisation of the NSW Government's railways allowing rail assets to be moved from the general government (budget) sector, in favour of the PNFC balance sheet. This allowed the capital and depreciation cost of public railways to be reported outside of the General Government Sector.

Corporatisation and commercialisation were progressively dismantled from the mid-2000s, following a series of rail incidents 42.

More recently, modernisation of transport planning and operations has seen a global trend toward modal integration, not separation.

In 2012 the ABS notified the NSW Government of its intention to reclassify the then-Rail Corporation of NSW (RailCorp) back to the general government sector, reflecting that it was no longer operating as a defensible public corporation, and was not charging economically significant prices or recovering a substantial degree of its costs, among other things. 43

NSW Government responded by developing a conceptual framework designed to allow NSW railway assets to continue to be reported on the PNFC balance sheet, rather than the State Budget. The resulting TAHE conceptual framework was agreed with the ABS in 2015, committing that:

- "TAHE will be an institutional unit established to manage transport assets for the government and other rail operators."
- "TAHE will generate a commercial return for the government and will charge economically significant prices for use of these assets."
- "TAHE will be expected to provide dividends from after tax profits to shareholders, comparable to an
  equivalent private sector business."
- "There will be limited competition as there will be no other entities owning/leasing rail assets in the same part of NSW."
- "Rail operators will have some choice in whether they use some of TAHE's assets or alternative transport options, based on price." 44

The agreement with the ABS also established a series of milestones to be met by the NSW Government, to show progressive movement toward the successful establishment of TAHE by an agreed 1 July 2019 start date.

#### TAHE's inclusion in the Transport Administration Act

To remain on-track with the establishment date, TAHE returned to the NSW Cabinet and subsequently, the NSW Parliament in 2017, seeing the passage of amending legislation to allow TAHE's subsequent creation as a statutory State-Owned Corporation (SOC).

The *Transport Administration Amendment (Transport Entities) Act 2017*<sup>45</sup> and the Treasurer's second reading speech provide further guidance on the anticipated purpose and function of TAHE at that time, reflecting:

- "TAHE would optimise the existing transport asset base, to enable a more effective, efficient and commercial approach to the management of transport assets, particularly property."
- "The creation of TAHE would allow transport operating entities to focus on their core functions of operating transport services and deliver improved customer service; and deliver on capital and recurrent budget targets."

<sup>41</sup> https://www.legisfation.nsw.gov.au/view/pdf/asmade/act-1996-56

https://www.treasury.nsw.gov.au/sites/default/files/pdf/Consolidated\_Financial\_Statement\_of\_the\_NSW\_Public\_Sector\_1996-97.pdf

<sup>42</sup> See Waterfall incident 2003, Albury incident 2006, Newbridge 2010, Central 2016 and Tempe 2017.

<sup>43</sup> https://www.parliament.nsw.gov.au/bill/files/3378/2R%20Transport.pdf

<sup>44</sup> Re: Final Determination of the classification of Transport Asset Holding Entity, Ian Ewing, Deputy Australian Statistician, 29 May 2015

<sup>45</sup> https://www.legislation.nsw.gov.au/view/html/inforce/current/act-2017-012

- "Nothing in the TAA amendment will change the framework for setting public transport fares as this will remain to be determined by TfNSW."
- "Sydney Trains and NSW Trains will continue to take responsibility for safety relating to the core
  operational assets."
- "Sydney Trains and NSW Trains are authorised under the bill to maintain rail infrastructure carriages, engines, plant machinery or equipment." 46

2017 also saw TfNSW and NSW Treasury, in conjunction with external advisors, continue to develop TAHE's business definition. This included:

- . TAHE would not be an operator or be responsible for operations of train services or the heavy rail network
- TAHE would not have network control functions. It will purely be an asset manager, providing access to
  assets or leasing assets out on a commercial basis. This is different to a pure asset owner as it would
  have a more active role in the management of its transport assets.
- · TAHE's functions could only be exercised under the authority of an operating licence with Government
- TfNSW would provide strategic direction on the use of transport assets and on maintenance and procurement requirements
- Rail assets under the current ownership of RailCorp would remain in TAHE, whilst other transport assets may be subsequently transferred into TAHE.<sup>47</sup>

#### TAHE 2018 - early 2020

TAHE saw only modest progress between 2018 and early 2020, reflecting an agreed extension to the planned 2019 'go live' to 1 July 2020; and the challenges created by changed accounting standards in 2018<sup>48</sup>; and the extreme complexity of developing a workable operating model.



<sup>46</sup> https://www.parliament.nsw.gov.au/bill/files/3378/2R%20Transport%20Entities%20LC.pdf

<sup>&</sup>lt;sup>47</sup> Cabinet Submission – Establishment of the Transport Asset Holding Entity, 3 March 2017.

<sup>&</sup>lt;sup>49</sup> https://www.treasury.nsw.gov.au/informat.on-public-entities/accounting-policy/aasb-1059-service-concession-arrangements-grantor; https://www.aasb.gov.au/admin/file/content105/c9/AASB10\_07-15\_COMPdec15\_01-18.pdf

#### TAHE in 2020

TAHE has seen renewed focus and momentum since early 2020; as the 'go live' date and fiscal reporting deadlines have made TAHE's successful establishment an increasingly urgent priority.

In its June 2020 consideration of TAHE, the NSW Cabinet authorised the corporation to be 'stood up' - and affirmed a return to Cabinet to address the key objectives outlined in this report, outlined in Figure 26 below.



#### **Fiscal**

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#### **Organisational**

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- Substitute of great mode man moreover the management of assets, commend a twiand management poiste use of audit funds.
- Pacitate the integration of networks, services and project planning, across modes and with a customerfocus.
- A low futule reform to rall service oe livery models.
- Account for the TAHE Board's outles and corporate objectives



#### **Operational**

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- Treate plean do da operational accountabilines petinien TPHE TPNSV/land la service operators

This report responds directly to Cabinet's request – developing a long-term TAHE operating model – which is then objectively assessed against each of Cabinet's TAHE objectives. The methodology of our approach is outlined in **Appendix 2**.

## Appendix 2 Our Methodology

TAHE has seen substantial high-level consideration over the past five years, but more limited effort has been applied to detailed definitions of what, when and how TAHE will perform its duties within the wider transport ecosystem.

#### Our approach

Accordingly, our approach has been based on research, modelling and analysis – overlaid by detailed and continuous consultation with TfNSW, TAHE and NSW Treasury officers.

We segmented the development of the TAHE long-term operating model through five stages; with a technical File Note provided to TfNSW and NSW Government stakeholders at each point.

- 1. **Defining TAHE's core business:** We used prior NSW Treasury and other inputs to distil; define and agree TAHE's core functions that it must control to satisfy Cabinet's fiscal objectives.
- Segmenting rail functions: We used TfNSW's RACI to provide an initial segmentation of detailed functions – adding further detail needed to provide customised RACIs across TAHE's key functions – allowing a clear picture of where accountabilities have changed. This resulted in the Functional Specifications File Note (18/08/2020).
- 3. Developing TAHE's ConOps & coordination measures: Using the agreed RACIs, we developed and tested a high level preliminary ConOps with key stakeholders; as well as outlining potential mechanisms to coordinate activities between TAHE and transport agencies 'business rules. This resulted in the Business Rules File Note (16/09/2020).
- 4. Develop and refine a robust TAHE financial model: We developed the 'KPMG TAHE Financial Model' from scratch, noting the limitations of the prior model outlined in our June 2020 report to Cabinet. This has allowed greater accuracy in understanding the consequential financial benefits and impacts posed by TAHE's move to charge fees and fund capital and operating activities on the NSW railway. This resulted in the delivery of the Financial Model File Note (04/09/2020).
- 5. Resourcing TAHE: We worked with TfNSW and TAHE's executive management to agree FTE manning assumptions based on the draft long-term operating model. This estimate has been used as an input to cost modelling and will depend on subsequent decisions by TAHE about its business undertakings and resourcing levels. The findings can be found in Appendix 4 of this report.



#### Defining TAHE's core business:

Using the baseline knowledge from our prior report Cabinet and our review of prior work on TAHE, our initial focus was on defining TAHE's 'relevant activities' -those areas over which TAHE must exhibit control and independence, to meet its fiscal objectives.

Noting TAHE's assets and state purpose, we defined these activities as:

- 1) Track access and asset licence pricing and terms;
- 2) Capital projects on TAHE assets;
- 3) Maintenance of TAHE's assets; and
- 4) TAHE's corporate financing and funding activities.

Our definition of TAHE's relevant activities was tested with a range of NSW Government stakeholders - and most particularly with NSW Treasury officers to provide us with comfort that these relevant activities support TAHE's fiscal objectives. Our consultations are outlined in Table 22.

Informing the development of TAH	E's core business	
People and Culture	Kirsten Watson, Deputy Secretary	09/07/20
Customer Strategy and Technology	Joost de Kock, Deputy Secretary	10/07/20
Greater Sydney	Elizabeth Mildwater, Deputy Secretary	10/07/20
Infrastructure and Place	Peter Regan, Deputy Secretary	13/07/20
Corporate Services	Fiona Trussell, A/Deputy Secretary	13/07/20
Safety, Environment and Regulation	Tara McCarthy, Deputy Secretary	14/07/20
Regional and Outer Metropolitan	Carol Anne Nelson, Deputy Secretary	14/07/20
Sydney Trains	Suzanne Holden, A/Chief Executive	17/07/20
NSW Trains (NSWT)	Pete Allaway, A/Chief Executive	17/07/20
People & Culture	Tracey Taylor, ED, Business Partnering	03/08/20
Customer Strategy and Technology	Susie Mackay, ED, Freight	28/07/20
Customer Strategy and Technology	Christina Limbidis, ED, Customer Strategy and Experience	16/07/20
Customer Strategy and Technology	Chris Bennetts, ED, Digital Projects	17/07/20
Customer Strategy and Technology	David Scott, ED, Advanced Analytics and Insights	27/07/20

Informing the development of TAH	E's core business	
Customer Strategy and Technology	Tim Raimond, ED, Future Transport	16/07/20
Greater Sydney	Craig Webster, CFO Greater Sydney	15/07/20
Greater Sydney	Tessa Knox-Grant, ED	17/07/20
Infrastructure and Place	Alex Wendier, Chief Development Officer	21/07/20
Infrastructure and Place	Peter Church, Head of Rail Delivery	21/07/20
Safety, Environment and Regulation	John Hardwick, ED Asset Management	22/07/20
Safety, Environment and Regulation	Nicole Albert, Director of Safety	23/07/20
Regional and Outer Metropolitan	Tom Grosskopf, Head of Sydney Planning	17/07/20
Corporate Services	Sally Web, Group General Council	21/07/20
RACI	NSW Treasury	18/08/2020 20/08/2020
TAHE business model	NSW Treasury / TfNSW / TAHE	19/08/2020

#### Segmenting rail functions

With agreement over TAHE's core business activities, we used the TfNSW RACI matrix to identify the functions and areas impacted by TAHE's transition to a long-term operating model. This allowed us to identify the detailed functions related to each area of TAHE's business – and provided a basis for these to be reallocated to reflect TAHE's future role.

 $\Omega ur$  initial allocation was conducted using a 'PNFC classification' approach, whereby we sought to allocate TAHE a demonstrable level of control and economic independence from the NSW Government.

The tables below outline the length and breadth of our consultations across TfNSW, TAHE and NSW Treasury officers, ensuring a detailed focus and agreement on the functional allocations.

It is worth noting that the functional allocations have changed repeatedly across the engagement, driven by evolving inputs from NSW Treasury, TAHE and Transport, ensuring that the long-term operating model supports NSW Government fiscal, operational and organisational objectives together with safety requirements.

Table 23: RACI workshop, 4/9/20

Relevant activity	Function	Prior RACI	Updated RACI	Requestor
Operational & non-	All	One slide	Division for operational and non- operational capital projects	TAHE
operational	Variations	N/A	Addition	TAHE

Relevant activity	Function	Prior RACI	Updated RACI	Requestor
capital projects	Asset acceptance	Split between non-reg and reg	Combination of non-reg and reg	TAHE
Non- operational capital projects	All, excluding:  Investment prioritisation  Prefeasibility funding  Deliver  Asset acceptance	N/A	<ul><li>A/R for TAHE</li><li>C for TfNSW</li></ul>	TAHE
Maintenance	SAMP TAHE SAMP	A for TfNSW A for TAHE	A / R for TfNSW  A / R for TAHE	TAHE, TINSW
	AMP	N/A	Division for operational and non- operational assets	
	Asset assurance	N/A	Reordered to follow AMP	NSW Treasury
	Variations	N/A	<ul> <li>Reordered to follow AMP</li> <li>Division for operational and non-operational assets</li> </ul>	NSW Treasury, TAHE
	Funding capital maintenance	C for TAHE     A / R for TfNSW	<ul> <li>A** for TAHE, with ** narrative –         Capital maintenance funding is from         TAHE – TAHE is the final decision         maker of funding envelope</li> <li>R for TfNSW</li> </ul>	TfNSW
	Appointment of maintainer	N/A	Addition	TAHE
	Maintenance services	N/A	Addition of * narrative – TfNSW (via ROM) responsible for managing private contractor for maintenance of CRN network)	TAHE

#### Table 24: RACI Workshop 8/9/20

Relevant activity	Function	Prior RACI	Updated RACI	Requestor
Operational	Investment	C for TAHE	A for TAHE	KPMG in
capital projects	prioritisation TAHE	<ul> <li>A / R for TfNSW</li> </ul>	<ul> <li>R for TfNSW</li> </ul>	response to
			<ul> <li>Reordered to be above Investment prioritisation</li> </ul>	workshop discussion

Relevant activity	Function	Prior RACI	Updated RACI	Requestor
	Strategic business case	<ul><li>C for TAHE</li><li>A / R for TfNSW</li></ul>	<ul><li>A for TAHE</li><li>R for TfNSW</li></ul>	and feedback (maintenance not yet
	Final business case	<ul><li>C for TAHE</li><li>A / R for TfNSW</li></ul>	<ul><li>A for TAHE</li><li>R for TfNSW</li></ul>	agreed)
	Funding for implementation	<ul><li>A for TAHE</li><li>A / R for TfNSW</li></ul>	<ul><li>A for TAHE</li><li>R for TfNSW</li></ul>	
	Asset acceptance	<ul><li>R for TAHE</li><li>A / R for TfNSW</li></ul>	<ul> <li>A*** for TAHE</li> <li>R*** for TfNSW</li> <li>Addition of *** narrative –         Financial acceptance is         determined by TAHE,         technical acceptance is         determined by TfNSW.</li> </ul>	
Non- operational capital projects	Investment prioritisation TAHE	N/A	Reordered to be above Investment prioritisation	
Maintenance	TAHE SAMP	N/A	Reordered to be above SAMP	
	Asset assurance	<ul><li>A / R for TAHE</li><li>R for TfINSW</li></ul>	<ul><li>A for TAHE</li><li>R for TfNSW</li></ul>	
	Variations: operational assets	<ul><li>A / R for TfNSW</li><li>R for Sydney Trains</li></ul>	<ul><li>A for TfNSW</li><li>R for Sydney Trains</li></ul>	
	Prioritisation of opex maintenance	N/A	Addition	
	Funding opex maintenance	<ul><li>C for TAHE</li><li>A / R for TfNSW</li></ul>	A for TAHE     R for TfNSW	
	Appointment of maintainer	<ul><li>A / R for TAHE</li><li>R* for TfNSW</li></ul>	<ul><li>A for TAHE</li><li>R* for TfNSW</li></ul>	
	Maintenance services	<ul> <li>A / R * for TfNSW</li> <li>A / R for Sydney Trains</li> </ul>	<ul> <li>A* for TfNSW</li> <li>R for Sydney Trains</li> <li>Alteration of * narrative –         External service providers         through TfNSW, such as CRN</li> </ul>	

Table 25. RACI Workshop 14/9/20

Relevant activity	Function	Prior RACI	Updated RACI	Requestor
Operational capital projects	Investment prioritisation Transport network	Titled 'investment prioritisation'	<ul> <li>Renamed</li> <li>Reordered to be above Investment prioritisation TAHE</li> </ul>	KPMG in response to workshop discussion and
	Gate 0: Need identification	<ul><li>C for TAHE</li><li>A / R for TfNSW</li></ul>	<ul><li>A for TAHE</li><li>R for TfNSW</li></ul>	feedback (maintenance not yet agreed
Non- operational capital projects	Investment prioritisation Transport network	Titled 'investment prioritisation'	<ul> <li>Renamed</li> <li>Reordered to be above Investment prioritisation TAHE</li> </ul>	
	Prefeasibility funding	No allocation for TfNSV	C for TfNSW	
	Gate 0: Need identification	<ul><li>A/R for TAHE</li><li>C for TfNSW</li></ul>	<ul><li>A/R for TAHE</li><li>R/C for TfNSW</li></ul>	
	Strategic business case	<ul><li>A/R for TAHE</li><li>C for TfNSW</li></ul>	<ul><li>A / R for TAHE</li><li>R / C for TfNSW</li></ul>	
	Final business case	<ul><li>A / R for TAHE</li><li>C for TfNSW</li></ul>	<ul><li>A / R for TAHE</li><li>R / C for TfNSW</li></ul>	
	Funding for implementation	<ul><li>A / R for TAHE</li><li>C for TfNSW</li></ul>	<ul><li>A / R for TAHE</li><li>R / C for TfNSW</li></ul>	
	Procurement	<ul><li>A/R for TAHE</li><li>C for TfNSW</li></ul>	<ul><li>A / R for TAHE</li><li>R / C for TfNSW</li></ul>	
,	Deliver	<ul><li>A for TAHE</li><li>C for TfNSW</li><li>R for Sydney Trains</li></ul>	<ul><li>A for TAHE</li><li>R / C for TfNSW</li><li>R for Sydney Trains</li></ul>	
	Variations	<ul><li>A/R for TAHE</li><li>C for TfNSW</li></ul>	<ul><li>A / R for TAHE</li><li>R / C for TfNSW</li></ul>	
	Asset acceptance	<ul><li>R for Sydney Trains</li><li>R* for NSW Trains</li></ul>	<ul><li>I for Sydney Trains</li><li>I* for NSW Trains</li></ul>	
Maintenance	Asset Assurance Framework	N/A	Addition	
	Asset assurance	<ul><li>A for TAHE</li><li>R for TfNSW</li></ul>	<ul><li>C for TAHE</li><li>A / R for TfNSW</li></ul>	
	<ul> <li>Funding TOTEX maintenance</li> </ul>	<ul> <li>Prioritisation of opex maintenance</li> </ul>	<ul> <li>Combination of functions into</li> </ul>	
	<ul> <li>Prioritisation of TOTEX maintenance</li> </ul>		'Funding TOTEX maintenance'	
		<ul> <li>Funding capital maintenance</li> </ul>	<ul> <li>'Prioritisation of TOTEX maintenance</li> </ul>	•

Relevant	and the second second		A CHARLES	
Relevant activity	Function	Prior RACI	Updated RACI	Requestor
Funding	Borrowing	C for TfNSW	I for TfNSW	

Table 26 RACI Workshop 16/9/20

Relevant activity	Function	Prior RACI	Updated RACI	Requestor
Non- operational capital projects	<ul><li>Investment prioritisation TAHE</li><li>Prefeasibility funding</li></ul>	<ul><li>A / R for TAHE</li><li>C for TfNSW</li></ul>	<ul><li>A / R for TAHE</li><li>R / C for TfNSW</li></ul>	ТАНЕ
Funding	<ul><li>Equity injections</li><li>CSO</li></ul>	Crown as a column title	ERC as a column title	NSW Treasury
Maintenance	<ul><li>Asset management plan</li><li>Variations</li></ul>	Split for operational and non-operational	Combined	KPMG

Table 27. Finalisation of RACIs for this Report 06 10/20 to 08/11/20

Relevant activity	Function	Prior RACI	Updated RACI	Requestor
Track access arrangements	Negotiate access arrangements	<ul><li>N/A for NSW Trains</li><li>I for TfNSW</li></ul>	C for NSW Trains     R for TfNSW	TAHE
	Daily Working Timetable (DWTT)	• I for TfNSW	C for TfNSW	TfNSW - PP
Operational capital projects	Deliver	A/R for TfNSW	A for TfNSW	TfNSW
Maintenance	Asset assurance	Definition: Monitoring to ensure maintenance is performed in line with specifications set out in plans and asset standards on behalf of TAHE and as 2 <sup>nd</sup> line of assurance.	Definition: Monitoring to ensure maintenance is performed in line with specifications set out in plans and asset standards on behalf of TAHE.	KPMG, to address TfNSW comments
		A for Sydney Trains	A./ R for Sydney Trains	TfNSW
All	All	Sydney Trains	Sydney Trains*	TfNSW

elevant ctivity	Function	Prior RACI	Updated RACI	Requestor
		eurobuser and selection for a foreign grant dependence and	Addition of * narrative reflects that this column refers to CRN or other maintenance providers.	
	Asset Assurance Framework	A / R for TAHE	A for TAHE	TfNSW
	Variations	Definition: Unforeseen identification, authorisation and delivery of maintenance; not within AMPs	Definition: Endorse unforeseen identification of maintenance; not within AMPs.	TfNSW
	Funding of TOTEX maintenance	Definition: Authorising of funding to O&M for operational and capital maintenance.	Definition: Endorse funding to O&M for operational and capital maintenance.	TfNSW
	TAHE Asset Performance Outcomes	TAHE SAMP	Altered function name to 'TAHE Asset Performance Outcomes'	
	TAHE SASP	Strategic Asset Management Plan	Altered function name to 'TAHE SASP'	KPMG, in response to stakeholder feedback
	TAHE ASP	None	Addition	
	ТАНЕ АМР	Asset Management Plan	Altered function name to 'TAHE AMP'	
	Appointment of maintainer	A for TAHE	A / R for TAHE	
	Funding of TOTEX maintenance	Definition: Endorse funding to O&M for operational and capital maintenance.	Definition: Endorse funding to M for operational and capital maintenance.	TAHE
	Prioritisation of TOTEX maintenance	Definition: Prioritisation and allocation of funding to O&M for operational and capital maintenance.	Definition: Prioritisation and allocation of funding to M for operational and capital maintenance.	TAHE
Finance and Funding	Grant funding	<ul> <li>Definition:         Amount of grant funding to support operator's operational and operational maintenance costs.     </li> <li>C for TAHE</li> </ul>	<ul> <li>Definition: Amount of grant funding to support TOTEX costs in relation to TAHE's assets.</li> <li>A for TAHE</li> </ul>	TfNSW

From this collaborative and iterative process, an agreed set of RACI functions were established, segmenting rail functions across TAHE's relevant activities.

#### Developing TAHE's ConOps and coordination measures

With the benefit of high-level agreement over TAHE's core business activities; and detailed agreement on the functional allocation in the amended TAHE RACIs; we then developed an initial Concept of Operations (ConOps) for TAHE – outlining a detailed concept of how TAHE would operate and interact, under its long-term operating model.

Noting that TAHE is an independent SOC, the concept of 'business rules' have been considered as a mechanism to drive coordination in rail transport, without imperilling TAHE's PNFC status.

We used the preliminary concept of operations to develop potential problems that could arise; and to consider where relevant legislative, regulatory or policy instruments could be used to achieve coordination or resolve disputes.

We used a simple 'problem/solution' approach to identify potential areas of conflict across TAHE's core business areas and underlying functions – and sought to link these to available mechanisms to resolve them. Table 28 lists the consultation undertaken in developing the TAHE ConOps and coordination measures.

Table 28: Operational design consultations

Informing the developme	nt of the preliminary 'business rules'	
ROM	Carol-Anne Nelson	20/08/2020
Safety & AM	John Hardwick / Nicole Albert	20/08/2020
P&C	Kirsten Watson / Tracey Taylor	24/08/2020
SER	Tara McCarthy	24/08/2020
GS	Elizabeth Mildwater	24/08/2020
Sydney Trains / NSW Trains	Suzanne Holden / Peter Allaway	25/08/2020
I&P	Alex Wendler	25/08/2020
NSW Treasury	Cassandra Wilkinson / Sajiv De Silva / Sean Osborn / Jeanne Vandenbroek / Scott Ellis / Howard Zhang / Andy Hobbs / Vincent Mercuri / Vincent Meney	18/08/2020 20/08/2020 25/08/2020 28/08/2020
I&P	Peter Regan / Peter Church	26/08/2020
CST	Joost de Kock / Susie Mackay / Christina Limbidis	26/08/2020
TAHE	Anne Hayes / Andrew Alam / Peter Crimp / George Roins / Leanne Grant	26/08/2020
NSW Treasury /	NSW Treasury / TfNSW / TAHE	03/09/2020 04/09/2020

l'able 29. Coe ations' assign consultations resonac-

Feedback on the preliminary	business rules'	
Detailed feedback from TAHE / High-level feedback from NSW Treasury	NSW Treasury / TfNSW / TAHE	10/09/2020
Detailed feedback from TAHE		11/09/2020
Detailed feedback from NSW Treasury / dry lease and maintenance		14/09/2020

#### Develop and refine a robust TAHE financial model

Our initial work on TAHE identified the need for a more sophisticated financial model, to allow a thorough assessment of the corporation's likely performance – and robust modelling of costs and net benefits (see **Section 2**). Accordingly, a key aspect of our work programme has been the development of new financial model, from the ground up. We followed a five-step process outlined below:

- Stage one agreed inputs & assumptions: Through detailed consultations and workshops, a set of inputs & assumptions were developed and agreed between TfNSW, TAHE and NSW Treasury.
- Stage two agreed architecture: All relevant aspects of our financial model were consulted with NSW Government stakeholders to seek an agreement on the model's architecture which would see the relevant outputs delivered within the context of agreed inputs and assumptions.
- Stage three agreed scenarios: A set of scenarios were agreed with all NSW Government stakeholders in order to holistically illustrate the financial impacts of TAHE; an agreed 'Base case' is used as a point of comparison to understand the relative fiscal impacts of TAHE remaining on the PNFC as a SOC.
- Stage four apply NSW Treasury-preferred assumptions: Detailed consultations with NSW
  Government Stakeholders revealed NSW Treasury's preferred revenue and commercial assumptions;
  these are applied to the scenario where TAHE remains on the PNFC as a SOC.
- Stage five assess net incremental impacts and results: Budget impact results from the model are
  assessed against the numbers provided to NSW Cabinet in the June 2020 submission; a detailed
  assessment on entity level impacts for TfNSW and TAHE is also performed, noting key caveats to
  TAHE's agreed commercial model.

Table 30 lists the engagement undertaken in developing the financial model, and in the financial analysis presented in this Final Report.

Table 30: Consultations undertaken on the financial analysis

Review of funds flow, inputs and assumptions	NSW Treasury / TfNSW / TAHE	14/08/2020
Access pricing	,	28/08/2020
Review of financial model of funds flow, inputs, assumptions, scenarios and outputs		15/09/2020

#### Resourcing TAHE

Only after the functions of the TAHE long-term operating model were determined was it possible to form a view on the FTE footprint needed for TAHE to execute its functions. This was done by taking the defined functions and consulting with TAHE and TfNSW to test and determine their view on staffing levels. The need, budget and investment required were tested with TfNSW before a high-level view of staffing, and where that staffing might come from, was articulated.

The organisational stage was concluded by forming a view and describing the impacts to Future Transport 2056 and the level of alignment to Evolving Transport. Again, a consultative approach was taken in workshopping with the TfNSW Evolving Transport leads to assess the extent of alignment.

Table 31 lists the consultation undertaken in the development of the organisational design of the TAHE long-term operating model.

Table 31: Consultations undertaken informing the organisational design

TAHE	Anne Hayes / Leanne Grant	03/09/2020
	Author Hoyes y Egonino Grone	11/09/2020
P&C	Kirsten Watson / Tracey Taylor / Katherine Freytag	07/09/2020
		09/09/2020
Safety & AM	John Hardwick	03/09/2020
		09/09/2020
cs	Fiona Trussell / Brenda Hoang / Sally Webb / Jonathon Deans /	09/09/2020
	Peter Perdikos	07/09/2020

## Appendix 3: Detailed overview of relevant legislation, regulation and policies

Aside from safety and environmental laws dealt with through the separate safety advice, there are a range of acts, regulations and policies that impact how TAHE may act, including:

- Transport Administration Act 1988 (TAA)
- State Owned Corporations Act 1989 (SOC Act)

TAHE's constitution

The NSW Rail Access Undertaking.

Their effect on TAHE's operating model is analysed below.

#### The Transport Administration Act

Section 10 of the TAA sees TAHE created to achieve five principal objectives, considered to be of equal importance. They are:

- (a) to undertake its activities in a safe and reliable manner,
- (b) to be a successful business and, to this end
  - (i) to operate at least as efficiently as any comparable businesses, and
  - (ii) to maximise the net worth of the State's investment in TAHE,
- (c) to exhibit a sense of social responsibility by having regard to the interests of the community in which it operates,
- (d) where its activities affect the environment, to conduct its operations in compliance with the principles of ecologically sustainable development contained in section 6 (2) of the Protection of the Environment Administration Act 1991,
- (e) to exhibit a sense of responsibility towards regional development and decentralisation in the way in which it operates. 49

Meanwhile, Schedule 1 of the TAA provides TfNSW, with general functions over infrastructure, including:

- a) Transport planning and policy 50
- b) Transport public funding 51
- c) Transport infrastructure 52
- d) Capital works programs and budgets 53
- e) Contracting for the delivery of transport<sup>54</sup> services
- f) Transport services co-ordination 55

- g) Incident management 56
- h) Transport information 57
- i) Provision and deployment of staff and services <sup>58</sup>
- j) Ticketing for transport services 59
- k) Precinct land planning 60
- I) Procurement 61

<sup>49</sup> Section 10(1), TAA 1988 (NSW).

<sup>50</sup> Ibid sch 1 pt 1a)

<sup>51</sup> Ibid pt 1(b)

<sup>52</sup> Ibid pt 1(c).

<sup>53</sup> Ibid pt 1(d).

<sup>54</sup> Ibid pt 1(e).

<sup>55</sup> Ibid pt 1(f).

<sup>56</sup> Ibid pt 1(g).

<sup>57 (</sup>bid pt 1(h).

<sup>52 |</sup>bid pt 1(i).

<sup>&</sup>lt;sup>59</sup> Ibid pt 1(j). <sup>60</sup> Ibid pt 1(k).

<sup>61</sup> Ibid pt 1(1).

#### m) Transport innovation. 62

Section 99D (2) of the TAA also provides the Minister for Transport & Roads with the power to appoint/terminate the Network Controller; the statutory position controls the Daily Working Timetable (DWTT) and any ad hoc or non-standard operations.

The Transport Administration Act's 2017 amendments created **TAHE** and contemplates functions in a number of areas:

- a) To hold, manage, operate, and maintain its transport assets. <sup>63</sup>
- Finance, establish, construct, develop and acquire transport assets to be vested or owned by TAHE. <sup>64</sup>
- c) To promote and facilitate access to that part of the NSW rail network vested in or owned by TAHE in accordance with the current NSW rail access undertaking.<sup>65</sup>
- To acquire and develop land to carry out its other functions.<sup>66</sup>

The Treasurer's second reading speech provides further insight into the contemplations of TAHE's functions, including to:

"Manage the State's portfolio of transport assets better and more commercially."

"Consolidate ownership within one entity ... rather than simply relying on the fragmentation of asset management and development across multiple entities."

"Provide a streamlined way for the State to manage any assets and liabilities that are no longer required for the delivery of transport services in NSW, rather than the piecemeal approach."

"[Provide] clear delineation between a publicly owned asset holder and the State as a direct service provider."

"Being more transparent about the way the State funds and accounts for [public transport assets]."

"Having a structure in place that properly accounts for the costs of recurrent service and capital expenditure and provides an identifiable return to the taxpayers on their massive investment in infrastructure. <sup>67</sup>

However, the TAA does not grant TAHE powers in these areas; section 14 of the TAA instead requires that TAHE must be granted an operating licence to perform functions in these, or any other areas; subject to the terms and conditions determined by the Minister, including:

- (a) compliance by TAHE with network and asset standard requirements issued from time to time by TfNSW.
- (b) a pricing regime or structure relating to assets leased or to which access is made available by TAHE,
- (c) airangements under which TAHE assets are leased or to which access is made available;
- (d) safety integrity,
- (e) integration of transport modes,
- (f) transport services which TAHE is permitted or not permitted to operate itself,
- (g) capital works programs, procurement and asset lifecycle (including maintenance or maintenance outsourcing),
- (h) businesses and activities conducted outside the State,

<sup>62</sup> lbid pt 1(m).

<sup>63</sup> lbid s 11(a).

<sup>64</sup> Ibid s 11(b).

<sup>65</sup> Ibid s 11(c).

<sup>66</sup> Ibid s 11(d).

<sup>&</sup>lt;sup>67</sup> Second Reading, Transport Administration Amendment (Transport Entities) Bill 2017 (NSW).

(i) development, use or disposal of TAHE's real property or transport infrastructure. 68

The tight framing of the requirement for an operating licence – and prohibitions on carrying out railway operations, operating a transport service or undertaking transport asset maintenance – appear to contemplate TAHE being required to operate synergistically with TfNSW. Simply put, for TAHE to achieve its statutory objectives, it must operate its business in a way that aligns with the wider transport priorities and planning.

#### Relevant transitional provisions related to TAHE under the TAA

Schedule 7 part 30 of the TAA provides transition provisions related to TAHE when it becomes a SOC. TAHE is required to submit a Statement of Corporate Intent but Schedule 7 states that the first Statement of Corporate Intent of TAHE may be extended by its voting shareholders but is not to exceed 3 months. <sup>69</sup> Additionally, TAHE is exempt from State taxes as a SOC for 12 months in respect of land owned by or leased to TAHE that is used primarily for railway purposes and any other matter or thing done by TAHE in the exercise of its functions. <sup>70</sup>

#### The State-Owned Corporations Act

Section 4 of the TAA established TAHE as a statutory SOC under section 20A of the SOC Act. <sup>71</sup> As per section 9 of the TAA, the provisions in Part 2 (TAHE) are in addition to and do not, except to the extent provided by Part 2, derogate from the provisions of the SOC Act. <sup>72</sup>

The SOC Act governs TAHE's operations as a statutory SOC - requiring that it:

- Not impose debts, liabilities or obligations on the State
- Accept direction from the Minister (with the approval of the Treasurer) to perform non-commercial functions – but that they be reimbursed any net cost from the NSW Treasury
- Pay to the Treasurer for payment into the Consolidated Fund tax equivalent payments
- Seek shareholder permission to acquire or dispose of its assets if greater than 10% of its written down value of its consolidated fixed assets
- Can be directed by the Minister (with the approval of the Treasurer) of a public sector policy that will
  apply to it provided it is reimbursed any net cost
- Be bound to meet a statement of corporate intent spanning three years, agreed in good faith with the shareholders – and laid before Parliament each year
- · Issue an annual report
- Can be directed by the Minister (with the approval of the Treasurer) if in the public interest to do so provided it is reimbursed any net cost
- · Can invest within private consortiums
- Be bound by provisions in its constitution.

The SOC Act, under Part 5, also creates directors' duties which are similar to those in the *Corporations Act* (Cth).

Within the SOC Act is also a Statement of Corporate Intent. A Statement of Corporate Intent (SCI) is an annual performance agreement between the Government, as owner, and TAHE. Section 21 of the SOC Act

<sup>68</sup> Section 14, TAA 1988 (NSW).

<sup>69</sup> TAA 1988 (NSW), sch 7 pt 30 s226.

<sup>70</sup> Ibid s227.

<sup>&</sup>lt;sup>21</sup> Section 4, TAA 1988 (NSW); Section 20A, SOC Act 1989 (NSW).

<sup>72</sup> Section 9, TAA 1988 (NSW).

requires TAHE to deliver an annual Statement of Corporate Intent (SCI). <sup>73</sup> As per section 22 of the SOC Act, this should outline, in the relevant financial year and each of the following two financial years:

- (a) the objectives of the corporation and of its subsidiaries,
- (b) the main undertakings of the corporation and of its subsidiaries,
- (c) the nature and scope of the activities to be undertaken,
- (d) the accounting policies to be applied in the financial reports of the corporation and of its subsidiaries,
- (e) the performance targets and other measures by which the performance of the corporation and of its subsidiaries may be judged in relation to their stated objectives,
- (f) the kind of information to be provided to the voting shareholders by the corporation during the course of those financial years, including the information to be included in each half-yearly report,
- (g) such other matters as may be agreed on by the voting shareholders and the board from time to time. 74

#### NSW Rail Access Undertaking & price regulation

The NSW Rail Access Undertaking seeks to encourage competition in the provision of train services by setting out pricing requirements and principles for Rail Infrastructure Owners.

The Undertaking is based on a hybrid of negotiate/arbitrate and direct price control regulatory approaches and applies to parts of the NSW rail network owned and operated by RailCorp (now TAHE).

- · The Metropolitan Rail Network (MRN);
- The Country Regional Network (CRN); and
- The five sectors of the Hunter Valley Coal Network (HVCN) between Newstan Junction and Woodville Junction.

The Undertaking requires prices to be set such that they are consistent with the floor test and ceiling test described in the NSWRAU.

- The ceiling is based on stand-alone costs and aims to prevent the regulated access provider from extracting monopoly profits
- The floor is based on 'avoidable costs' and aims to ensure that prices are not set so low that some rail
  operators do not pay for the costs of the services they use.

The undertaking requires the rail infrastructure owner (i.e. TAHE) to comply with the IPART review process. TAHE will need to decide if TfNSW will submit information on its behalf.

The undertaking sets out principles for the roll forward of the regulatory asset base.

IPART must determine whether TAHE has complied with the NSW Rail Undertaking each year, with the exception of non-HVCN sectors where access revenue below 80 per cent of the 'full economic cost'. In this instance a compliance review is only required every five years.

A key functionality of the more developed KPMG TAHE Financial Model is the ability to calculate the Full Economic Cost and in turn, the IPART floor and ceiling (see **Section 2**).

#### Rail Services Contract

In June 2013, TfNSW and RailCorp entered into Rail Services Contracts (RSCs) with NSW Trains and Sydney Trains. In consideration of the broader legislative context and each party's prescribed roles and responsibilities under the TAA, the RSCs' primary purpose is to further clarify each agency's legislative

74 Section 22, SOC Act 1989 (NSW):

<sup>73</sup> Section 21, SOC Act 1989 (NSW).

functions, such that the RSCs are more akin to 'memorandums of understanding' among the parties to the RSCs

The purpose of the RSCs 75 is to:

- Provide further clarity on roles and responsibilities between the parties in the delivery of railway
  passenger services as a further extension of the roles and responsibilities assigned to TfNSW and the
  rail operators through legislation
- Facilitate delivery of the government's plans and policies
- Provide a structure for the parties to plan for a transport system meeting the needs of the public, provide integration at decision making level across all public transport modes and promote safe and reliable delivery of public transport and freight services
- Enable TfNSW to coordinate and implement integrated transport solutions for NSW, including oversight
  of performance standards and safety requirements
- Specify requirements for rail operators and TfNSW's delivery of their respective services in relation to planning, implementation, improvement and reporting requirements.

Importantly, the RSCs have been extended beyond their original term ending in 2018 and the current contract term ends on 30 June 2021. <sup>76</sup> The RSCs fulfilled a role, which remain unchanged in the time they were originally supposed to be re-negotiated, and as such the term was extended. Additionally, there was not a clear driver to amend the RSCs and the agreed path forward was to extend them in their then current state, with a view to considering amendments once TAHE was stood up.

The new term provides an opportunity to renegotiate the RSCs on terms that align with the TAHE long-term operating model.

#### Operating Licence

The operating licence is the key legal instrument that authorises TAHE to exercise its specific functions. TAHE's is currently operating under an interim operating licence, issued for the period 1 July 2020 to 30 June 2021, and this enables the legislative functions of TAHE. That is to say, TAHE's functions may only be exercised under the authority of its current operating licence. The operating licence provides detailed requirements and limitations on TAHE's role in relation to pricing regimes, access to assets, safety integrity, operating constraints, capital works programme, procurement, maintenance and maintenance outsourcing. The operating licence was granted subject to certain conditions, in particular:

"TAHE is to have regard to safety, integrity and the policies and objectives of the NSW Government in relation to integration of transport modes.

TAHE must comply with certain TfNSW Asset Standards Requirements.

TAHE must not carry out railway operations or operate a transport service unless it has written approval of the Minister.

TAHE must not maintain its transport assets other than by having in place arrangements (including with Sydney Trains under the Rail Services Contract) under which another person is required to maintain such Transport Assets.

TAHE may conduct business or activities outside NSW, provided that such business or activities were conducted by RailCorp immediately prior to the establishment of TAHE or with the approval of the Minister.

<sup>75</sup> Rail Services Contracts, clause 2 Contract Objectives

<sup>76</sup> Rail Services Contracts, clause 3.2 Further Term

<sup>&</sup>quot; TAHE Operating Licence, 30 June 2020.

<sup>78</sup> Cabinet Submission, Establishment of the Transport Asset Holding Entity, 2017.

TAHE must continue to work towards delivery of specified Ongoing Projects in accordance with the relevant Cabinet approval for the Ongoing Projects and the NSW Government Capital Investment Plan, subject to funding being available." <sup>79</sup>

#### Other relevant NSW Government policies

Framework

The NSW Treasury's commercial policy framework constitutes the basis of the 'SOC toolkit' referred to in reference to TAHE. Relevant policies include:

- Financial distribution (TPP 16-4)
- Performance Monitoring and Reporting (TPP18-02)
- Capital structure (TPP 16-3)
- Guidelines for Governing Boards (TPP17-10)
- Board and CEO appointments (TPP18-08 and TPP17-11)
- Guidelines for Community Service Obligations (TPP19-02)
- Major Projects (TPP18-05).

Capital (Janning and Calivery

The NSW Government's capital planning and delivery guidelines will also apply to any projects contemplated by TAHE, including:

- Major Projects Policy for Government Businesses (TPP18-05)
- NSW Gateway Policy: Policy & Guidelines Paper (TPP 17-01)
- Asset Management Policy (TPP19-07)
- INSW infrastructure Investor Assurance Framework (IIAF).

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If implemented a Statement of Expectations is designed to clarify the Government's expectations for TAHE's commercial operations. The statement is developed collaboratively between TAHE and the Portfolio Minister, and in consultation with the Treasurer. It should provide long-term objectives, covering a period of at least four years. It is yet to be confirmed if a Statement of Expectations will be implemented for TAHE.

<sup>79</sup> TAHE Operating Licence, 30 June 2020.

## Appendix 4: Estimated Resourcing

The resourcing requirement for TAHE has been developed to align with TAHE's functional allocations described in **Section 1**, and the following principles:

- Align to TAHE core functional requirements (e.g. SOC Act, Operating Licence or Independence requirements);
- Support financial sustainability;
- · Small organisation with a lean team; and
- Minimise role duplication across the transport cluster.

A key component of these guiding principles relates to the overlap in cross-agency capabilities. Where possible, duplication of roles with TfNSW, operators and other government departments has sought to be minimised, instead outlining where capabilities from these teams could be leveraged through a fee for service arrangement.

Some roles must be duplicated to a degree as the associated function is required to be executed independently of TfNSW to ensure there are no conflicts of interest (e.g. assurance) and support TAHE management and Board discharge their fiduciary duties as an independent SOC.

We have applied the relevant TfNSW pay scales for all positions save for the CEO, where we have reflected stakeholder input suggesting equivalence to other major NSW SOCs.

#### Functions and responsibilities

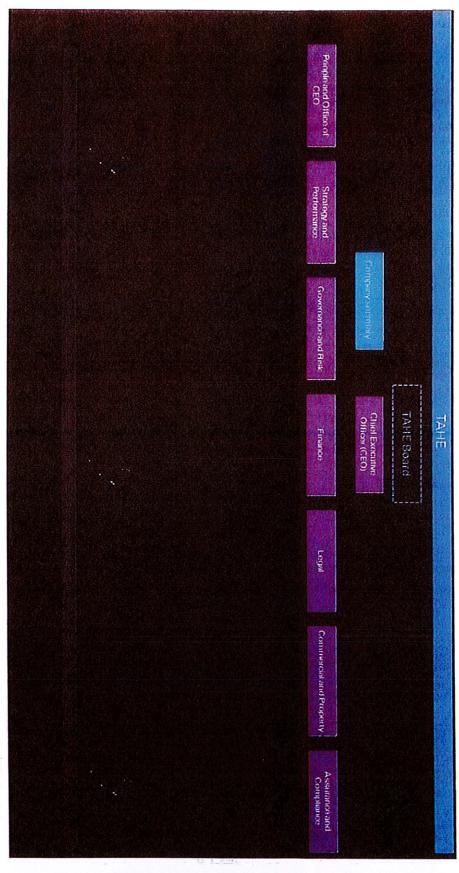
TAHE's long-term operating model contemplates an executive structure across seven functions, being:

- 1. The CEO, CEO support office and HR;
- 2. Strategy and Performance;
- 3. Governance and Risk;
- 4. Finance;
- 5. Legal;
- 6. Commercial and Property; and
- 7. Assurance and Compliance.

These core functions are assumed to be supported by TfNSW corporate services, e.g. IT support, Payroll etc., defined as Support functions, and several Executive Assistants (EA).

The functional model contemplates TfNSW providing aspects of several core functions through a contractual arrangement on a fee for service basis. These include, but are not limited to, capital project delivery (I&P), assurance and oversight services (SER), maintenance contract management (ROM), and business case development (GS, ROM, I&P). The responsibilities of the core and support functions are outlined in the figure below. This is an overview for the purposes of preliminary costing and a high level ConOps only and is subject to change in all regards by TAHE's Board and management.

Figure 27. Overview of TAHE functions and responsibilities



Note: All analysis pertaining to the TAHE resourcing requirement is for costing purposes only and is not indicative of actual roles, organisational structure and associated budget for TAHE. Detailed capability benchmarking and role sizing must occur and is subject to approval by the TAHE Board, before these positions can be enacted

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#### Expected FTE requirements & cost assessment

The preliminary analysis suggests between 37 and 45 FTEs are required to resource TAHE's relevant corporate functions; with a balance of support services assumed to be provided to TAHE by TfNSW and its agencies; on a fee for service basis. The current PRIME estimates include allocations for administration and corporate services provided. This this will need further review and adjustment in the future between TfNSW and TAHE when arrangements are confirmed.

The total expected cost to resource the core functions of TAHE is approximately \$9.3 to \$10.6 million per annum, as outlined in Table 32.

Business Function	Estimated FTE requirement		
CEO and Office of the CEO (incl. Company Secretary)	6		
Strategy and Performance	3 – 4		
Governance and Risk	3		
Finance	4 - 6		
Legal	3		
Commercial and Property	9 – 14		
Assurance and Compliance	5		
Executive Assistants	4		
Total FTE requirement	37 - 45		
Total cost (Salary + on cost \$ p.a.)	\$ 9,304,265 - 10,614,623		

Estimate cost estimates are calculated using TfNSW salary bands, noting that TAHE as a State Owned Corporation will develop and implement independent remuneration arrangements. The basis for cost calculation, including the relevant TfNSW salary bands used, can be provided upon request.

## Appendix 5: TAHE Financial Model

See attached for the excel financial model associated with this report.

Filename: Appendix 5 - TAHE October Op Model\_16102020.xlsm

## Appendix 6 TAHE Initial Assessment of Options

See attached for the prior report completed by KPMG and submitted to TfNSW in May 2020.

Filename: Appendix 6 - TAHE Initial Assessment of Options - 18 May 2020 Final.pdf

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Appendix 6 - TAHE Initial Assessment of (

## Appendix 7 NSW Draft Cabinet Submission - Establishment of the Transport Asset Holding Entity (TAHE)

See attached for the NSW Draft Cabinet Submission titled Establishment of the Transport Asset Holding Entity (TAHE) submitted on the 25th May 2020.

Filename: Appendix 7 - TAHE Draft Cabinet Submission - 25 May Final Draft.pdf



Appendix 7 - TAHE
Draft Cabinet Submiss

## Appendix 8 NSW Treasury perspective on assumptions

See below for an excerpt from the NSW Treasury position paper on TAHE Financial impacts dated 23 October 2020. This table outlines NSW Treasury perspectives on the KPMG TAHE Financial Model assumptions. We have included this table for transparency, and at the request of NSW Treasury.

Table 33, Experpt from NSvV Treasury's position paper utiled TAHE financial impacts, dated 23 October 2020

#	Assumption	Financial Acct	Progress Made	October Position	Subject to change	Next Steps
1	Access and Lease Fees	Revenue	Indicative floor and ceiling price calculated, as per RAU.	Not determinable	Valuations, final balance sheet, IPART strategy and determination and Budget	Engage with IPART Establish IPART reg model RSC's
2	Substance of Fees (Accounting treatment)	Revenue	No Progress. Not possible to determine accounting treatment of agreements based on RACI.	Not determinable	RSCs and commercial agreements need to be redesigned by 1 July 2021.	Accounting treatment of agreements between parties Dependency on 1
3	Covid Impacts	Revenue	No progress	Not determinable	Covid impacts on commercial agreements needs to be assessed as part of 2.	Transport to provide inputs
4	Commercial Strategy and forecasts	Revenue	Preliminary strategy under development.	Not determinable	Final strategy to be to vary based on 1,2, 9, 10, 11.	TAHE to continue to develop asset and commercial strategy concurrently with other streams
5	NTER and Taxes	Expenses	No progress	Not determinable	NTER and other tax liabilities to be assessed over time.	TAHE to engage with tax specialists.
6	TSS Agreement (including I&P)	Expenses	No progress	Not determinable	Risk allocation, funding management and contingency management	TAHE to engage with I&P and begin developing terms for the agreement.

					subject to terms of agreement	
7	TAHE Resources	Expenses	Preliminary org. structure still in development	Not determinable	Dependant on scope of access fee agreement.	Finalise organisational review – will be ongoing.
8	Depreciation	Expenses	Forecasted depreciation will change subsequent to valuation approach	Not determinable	Subject to 1,2 .4,5.	Accounting treatment of agreements between parties
9	Debt (Target capital structure)	Liabilities	No progress	Not determinable	Subject to 1,2,3, 4,5	Finalise balance sheet review
10	Credit Rating	Liabilities / Expenses	No progress	Not determinable	Subject to 1,2,3, 4,5.	Finalise balance sheet review
11	Equity Injections	Assets	Still under development – dependant on access and lease fees	Determinable	Carry Forwards, contingency reallocation and over programming budgets	TAHE to engage with TFNSW Finance and Treasury
12	CIP Re- profile	Assets	Preliminary work underway	Not determinable	Commercial strategy and item 3.	Transport to provide inputs
13	Asset valuation basis	Assets	July 2020 agreed, No progress going forward	Not determinable	Potentially subject to change in future	Agreements will potential trigger valuation basis
14	Dividends	Distributions	No progress	Not determinable	Subject to 1,4,5,6 and 11	Continue to deliver above items and streams

## Appenaix 9 Stakeholder input and engagement

During the development of this Final Report and related deliverables KPMG engaged extensively and regularly with TAHE and NSW Treasury. Feedback was received verbally during workshops and consultations, or in written form. Appendix 9 outlines where key stakeholder consultation occurred, and provides transparent evidence of where comments were received, analysed and adopted – or not actioned with explanations provided.

#### Long-term operating mode

- Functional allocations changed repeatedly across the engagement, driven by evolving stakeholder input.
   This required extensive consultation with TfNSW divisions, as well as several workshops with TAHE and NSW Treasury.
- Workshops were conducted with stakeholders on operational and non-operational capital project case studies. Consensus was reached on case studies between stakeholders.
- TAHE prepared four rounds of comments on draft versions of the Final Report. KPMG prepared written
  responses to all TAHE's comments. KPMG responses noted where comments were adopted, with
  explanations or additional action provided if not. Details of the comments and responses can be found in
  the change log provided below:

Filename: Appendix 9B - Change log - 6 November 2020.xls

See tab "TAHE"



Appendix 98 – Change log – 6 Novei

 As mentioned, KPMG consulted extensively and regularly with TfNSW divisions, operators, TAHE and NSW Treasury on a range of operational, organisational and financial issues. Refer to the stakeholder consultation section of *Appendix 2: Methodology* for the list of meetings that occurred. This is broken down by each workstream.

#### KPMG TAHE Financial Model

- KPMG consulted extensively with TAHE and NSW Treasury on the development of the KPMG TAHE
  Financial Model. Refer to footnotes 20, 21, 22, 23 and 31 of this document which outline the extensive
  meetings that occurred to determine assumptions.
- KPMG prepared a written response to NSW Treasury's position paper which included written feedback on the TAHE financial impacts, dated 23 October 2020.

Filename: Appendix 9A - Treasury comment log response.pdf



Appendix 9A -Treasury comment log

KPMG prepared written responses to TAHE and NSW Treasury's comments on the KPMG TAHE
Financial Model and have indicated whether the comment was incorporated into the financial model,
with explanations provided if not.

Filename: Appendix 9B - Change log - 6 November 2020.xls

See tab "Financial Model - Various"

## Appendix 10: TAHE Operating Licence

See attached for the PDF of Transport Asset Holding Entity of New South Wales (TAHE) – Approval of Operating Licence.

Filename: Appendix 10 - TAHE Operating Licence - Signed.pdf



Appendix 10 - TAHE Operating Licence - S



# Contact us

Brendan Lyon Partner M: 0403 504 548 E: blyon@komg.com.au



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