

## WHAT

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This document is the statement of reasons for IPART's decision on RailCorp's compliance with the New South Wales Rail Access Undertaking (the undertaking) for 2017-18 for the:

- ▼ Metropolitan Rail Network (MRN)
- ▼ Country Rail Network (CRN)
- ▼ Northern Sydney Rail Corridor (NSRC).

We are reasonably satisfied that RailCorp's access revenue is no more than 80% of the full economic cost for these networks. As such, we are satisfied that RailCorp has complied with the requirements of the undertaking in relation to these networks.



## WHY

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Under section 5(f) of the undertaking, rail infrastructure owners (for networks that are not Hunter Valley Coal Networks) do not need to demonstrate compliance with the asset valuation roll-forward and ceiling test requirements in the undertaking if they can demonstrate to IPART's reasonable satisfaction that the access revenue is no more than 80% of the full economic cost of providing access.



## WHO

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The compliance review covers RailCorp's three non-Hunter Valley Coal Networks,

which have traditionally met the requirements in section 5(f).



## HOW

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IPART reviewed RailCorp's compliance submission for each of the three networks. We have considered the reasonableness of the cost estimates proposed, and have had regard to an indicative asset valuation using a depreciated optimised replacement cost (DORC) methodology.



## WHAT NEXT

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IPART requires RailCorp to submit its 2018-19 compliance information by 31 October 2019.

For the next four compliance years, IPART requires Transport for NSW to confirm that there have been no material changes in cost or revenue for any of these networks that would cause access revenue to approach the 80% threshold in relation to each of these three networks.

Where there have been no material changes, ceiling test information will be required again for the 2022-23 compliance year.

## 1 How compliance is assessed for these networks

Compliance for all three networks is done under section 5(f) of the Rail Access Undertaking, which provides for a more light-handed compliance assessment where access revenue is relatively low. In order to fall under this section, the network cannot be part of the Hunter Valley Coal Network. Section 5(f) requires IPART to be reasonably satisfied that access revenue is no more than 80% of the access revenue likely to be derived by application of the ceiling test.

If section 5(f) applies, then rail infrastructure owners do not need to demonstrate compliance with the asset valuation roll forward principles nor the ceiling test required by section 5(b).

For RailCorp's non-Hunter Valley Coal Networks, IPART has assessed whether section 5(f) applies by requiring:

- ▼ Five yearly ceiling test information (MRN and CRN)
- ▼ More frequent ceiling test information where it appears that access revenue is approaching the 80% threshold or is rising quickly (the NSRC)
- ▼ Statements confirming that there have been no significant changes in the intervening years.

## 2 Metropolitan Rail Network and Country Rail Network

Our assessment for 2017-18 has confirmed that access revenues for the Metropolitan Rail Network and the Country Rail Network were well below the 80% threshold.

Our assessment of full economic costs used RailCorp's proposed operations and maintenance (O&M) costs with an efficiency adjustment consistent with the adjustment made for RailCorp's Hunter Valley Coal Network.

RailCorp advised that its O&M cost estimates were made on the same basis as its estimate of these costs for the Hunter Valley Coal Network, which was based on a benchmark rate of \$10 per gross tonne kilometre. RailCorp's analysis did not include any capital costs (return on or of capital) – the inclusion of these costs would lower access revenue as a proportion of full economic cost.

### RailCorp's proposal

RailCorp considers that for both the MRN and CRN access revenue is well below full economic costs, even if capital costs are set to zero. RailCorp submits that for the MRN, in 2017-18, O&M costs alone are almost double access revenue and for the CRN, O&M costs alone are almost 10 times access revenue, based on the same methodology using RailCorp's cost estimates.

RailCorp's proposed full economic costs are set out in Table 2.1. RailCorp's estimate of full economic cost does not include any amount for return on or of capital and is therefore likely to understate actual costs. RailCorp has not provided a breakdown of information by corridor.

**Table 2.1 RailCorp's compliance submission – MRN and CRN 2017-18**

	MRN	CRN
Maintenance costs	31,624,785	96,902,690
Network control costs	3,912,659	-
Corporate and system overheads	4,868,630	5,864,209
<b>Total O&amp;M</b>	<b>40,406,074</b>	<b>102,766,899</b>
Depreciation	-	-
Return on RAB	-	-
<b>Full economic cost (FEC)</b>	<b>40,406,074</b>	<b>102,766,899</b>
Access revenue	23,049,664	10,361,848
Access revenue less FEC	-17,356,410	-92,405,051
<b>Recovery rate</b>	<b>57%</b>	<b>10%</b>

Source: RailCorp's compliance proposal, Metropolitan Rail Network and Country Rail Network

## IPART's analysis

In our draft decision on compliance for RailCorp's Hunter Valley Coal Network (available on IPART's website), we found that the maintenance cost estimates and corporate and system overheads proposed by RailCorp were higher than reasonable.<sup>1</sup> We have applied the same percentage reductions in maintenance and overhead costs that we adopted for the Hunter Valley Coal Network to the MRN and CRN, as an estimate of efficient O&M costs. The O&M cost estimates for each network used in our analysis are:

- ▼ 78% of RailCorp's proposed maintenance costs
- ▼ 100% of RailCorp's proposed network control costs
- ▼ 54% of RailCorp's proposed overhead costs.

After making these efficiency adjustments, access revenue is still below the 80% threshold for both networks, even without any return on assets or depreciation included (Table 2.2).

**Table 2.2 IPART adjusted costs**

	MRN	CRN
Maintenance costs	24,708,732	75,710,952
Network control costs	3,912,659	-
Corporate and system overheads	2,624,745	3,161,475
<b>Total O&amp;M</b>	<b>31,246,136</b>	<b>78,872,428</b>
Depreciation	-	-
Return on RAB	-	-
<b>Full economic cost (FEC)</b>	<b>31,246,136</b>	<b>78,872,428</b>
Access revenue	23,049,664	10,361,848
Access revenue less FEC	-8,196,472	-68,510,580
<b>Recovery rate</b>	<b>74%</b>	<b>13%</b>

<sup>1</sup> The HVCN maintenance cost estimates were based on a benchmark rate of \$10 per gtk. The overheads were based on a percentage of maintenance and network control costs.

On the basis of this analysis, we consider that RailCorp has demonstrated to a reasonable level of satisfaction that its access revenue is below the 80% of full economic costs for 2017-18 for both the Metropolitan Rail Network and Country Rail Network.

### 3 Northern Sydney Rail Corridor

Our analysis shows that access revenue on the Northern Sydney Rail Corridor is also below the 80% threshold based on reasonable cost assumptions.

Our assessment used RailCorp’s proposed O&M costs with an efficiency adjustment consistent with the adjustment made for the Hunter Valley Coal Network, as we did for the MRN and CRN.

It also included consideration of RailCorp’s proposed Regulatory Asset Base (RAB).

#### RailCorp’s proposal

Like the MRN and CRN proposals, RailCorp has based its O&M costs on the approach used for the Hunter Valley Coal Network. Unlike the MRN and CRN proposals, RailCorp has included capital costs for the Northern Sydney Rail Corridor. RailCorp established a RAB for the NSRC using the book value in Sydney Trains’ fixed asset register and then used depreciation and a rate of return consistent with the Hunter Valley Coal Network to calculate annual capital costs. RailCorp’s proposed full economic costs are set out in Table 3.1.

**Table 3.1 RailCorp’s compliance submission – NSRC**

	<b>NSRC</b>
Maintenance costs	30,295,630
Network control costs	3,359,455
Corporate and system overheads	4,610,747
<b>Total O&amp;M</b>	<b>38,265,832</b>
Depreciation	87,055,477
Return on RAB	204,682,640
<b>Full economic cost (FEC)</b>	<b>330,003,949</b>
Access revenue	25,982,297
Access revenue less FEC	-304,021,652
<b>Recovery rate</b>	<b>8%</b>

Source: RailCorp’s compliance proposal, Northern Sydney Rail Corridor

#### IPART’s analysis

Access revenue is below 80% of RailCorp’s proposed O&M costs. However, as for the CRN and MRN we applied an efficiency adjustment to these costs. The O&M cost estimates for each network used in our analysis are:

- ▼ 78% of RailCorp’s proposed maintenance costs
- ▼ 100% of RailCorp’s proposed network control costs
- ▼ 54% of RailCorp’s proposed overhead costs.

Access revenue is 88% of the efficiency adjusted O&M costs (that is, with no capital costs included in the assessment). As a result, we have also considered a reasonable regulatory asset base value for this network.

As compliance has always been assessed under section 5(f), no RAB has been established for the NSRC. RailCorp has proposed a RAB based on its book value (\$3.48 billion) and has used this to estimate a return on and of capital for its ceiling test calculation. These costs account for almost 90% of RailCorp's full economic cost estimate.

Section 5(f) of the undertaking states that IPART must have regard to an indicative regulatory assets valuation based on a Depreciated Optimised Replacement Cost (DORC) methodology. As a DORC methodology optimises the assets, it is likely that this approach would result in a lower RAB than the book value adopted by RailCorp, particularly as the NSRC is a shared passenger and freight line.

The use of a substantially smaller RAB than proposed by RailCorp would still result in access revenues below the ceiling test. In order for access revenue to reach the 80% threshold, using our efficiency adjusted O&M costs, the capital costs (return on assets plus depreciation allowance) required to reach this threshold at the current level of access revenue is just 1% of the capital costs proposed by RailCorp (Table 3.2). As a result, we are reasonably satisfied that a DORC valuation of the Northern Sydney Rail Corridor would not be so low that it would cause revenue to exceed the 80% threshold.

**Table 3.2 Capital costs required for access revenue to reach the 80% threshold**

Maintenance costs (with efficiency adjustment)	23,670,251
Network control costs	3,359,455
Corporate and system overheads (with efficiency adjustment)	2,485,717
<b>Total O&amp;M (with efficiency adjustment)</b>	<b>29,515,423</b>
<b>Capital costs required</b>	<b>2,995,743</b>
<b>Full economic cost</b>	<b>32,511,166</b>
Access revenue	25,982,297
Access revenue less FEC	-6,528,869
<b>Recovery rate</b>	<b>80%</b>