Select Committee

Port of Melbourne lease transaction

8 September 2015

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Port of Melbourne lease transaction

Victorian economic context	• Victoria's population is estimated to reach 10 million by 2051 • Victorian population growth will translate into trade growth, an increased freight task and broader infrastructure needs (eg. transport networks, urban development)
Lease term	• The proposed lease term is 50 years • Under regulation, the lease can be extended by up to 20 years
Second port	• The lease does not rule out a second container port • Under the transaction the State retains unfettered and strategic flexibility to develop a second container port • Current and developable capacity at the Port of Melbourne (PoM) remains the best outcome for the State against the alternatives • The Port Growth Regime aligns leaseholder's interests with the State to optimise natural container capacity of PoM and among other conditions, only becomes payable if Government diverts containers that would have been accommodated within an amount of capacity at PoM predefined through the competitive Transaction Process
Separation	• Port of Melbourne employees will be treated fairly and equitably • The PoM's assets (including employees), liabilities, rights and functions are to be separated into two on-going entities • The PoM's commercial operations will transfer to the leaseholder • The State retains marine side, navigation, emergency management and regulatory functions and Station Pier and West Finger Pier

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Planning and environmental approvals	• Planning and environmental approvals will not change • Victorian and Commonwealth governments retain responsibility for regulating port safety and environmental and planning approval functions
Strengthened economic regulation	• Strengthened economic regulatory regime • ESC continues as the independent economic regulator for non-rent port changes • Legislation provides price certainty through a CPI price cap for 15 years • A 2.5 per cent reduction on PoM international container export charges • A pricing order to give effect to the strengthened economic regulatory regime
Transaction features	• 50 year lease term • Strengthened economic regulatory regime • Establishing a Port Growth Regime to align the interests of the State and leaseholder to optimising PoM capacity ahead of the development of a second container port. • The State retains the unfettered and strategic flexibility to develop a second container port when demand requires it

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Port of Melbourne lease transaction – Terms of Reference

Structure and duration

Managing long-term State policy needs and preserving strategic flexibility

Structure	• Assets, functions and rights required to provide and support PoM commercial operations , including channel use • State retains marine side, navigation, emergency management and regulatory functions and Station Pier and West Finger Pier • No right for second container port development is included in the Transaction
Duration	• Proposed lease term is 50 years • Under regulation, lease can be extended by up to 20 years

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Proposed economic regulatory framework

Strengthened: building block principles, encouraging capacity investment, efficient costs and additional protections for port users

Proposed regime	• ESC continues as the independent economic regulator • Prescribed services will be expanded to cover all trade charges for cargo and shipping movements • Land rents continue to be set by contract, reflecting market rent and typically determined by independent valuer • Future prices set by clearly established economic pricing principles and a deemed asset base consistent with the building block model principles for similar regulated assets • Price certainty provided through an overriding CPI price cap for 15 years with annual compliance monitoring by the ESC • Non-discrimination controls protect Geelong Port (and future port) users of the shared channel

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Freight and logistics competitiveness

Regulatory regime, enshrined in legislation, promotes efficient costs in supply chain
PoM has natural location and pricing advantages compared to alternatives

PoM contribution to supply chain	• PoM's trade charges are a low contributor (12%) to industry supply chain costs • Supply chain efficiency is oriented around the PoM's location • Relocation of supply chain is expected to add to industry costs • Competitive port charges compared to major east coast ports
Benefits of the proposed regulatory arrangements	• More robust and comprehensive regulatory regime than the existing approach • Appropriate incentives to maximise overall port efficiency • Export pricing discounts 'locked in' • Underpins competitiveness of Victorian freight and logistics industry • Provides clarity and certainty for State, port users and investors, with safeguards for users

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PoM expansion: environmental impacts

Statutory environmental and planning regimes remain unchanged

Environmental and planning regime	• Environmental accountability and performance embedded in Commonwealth and State law • Ministers for Environment, Planning and Ports remain responsible for accountability, planning and environmental performance and protections • Environmental conditions are well understood and documented compared to other expansion locations
Channel	• Channel depth considered currently sufficient – any increases driven by freight task (ship fleet follows freight rather than the other way round) • Leaseholder to conduct periodic dredging within permit approvals
Landside	• The State will need to consider future landside infrastructure requirements in line with Victoria's population growth. • Relatively low percentage of traffic utilising the road network in and around the port is port-related traffic compared to general traffic • State is reviewing a range of road network investments which could provide additional connectivity to PoM • State retains ability to manage landside issues as and when they arise and add further road capacity from time to time as required when congestion occurs • Leaseholder to provide State with development plans for PoM to inform State's landside considerations
Local amenity	• Leaseholder to maintain community assets, such as Perce White Reserve and maintain existing non-operational land to manage the interface between PoM and the community

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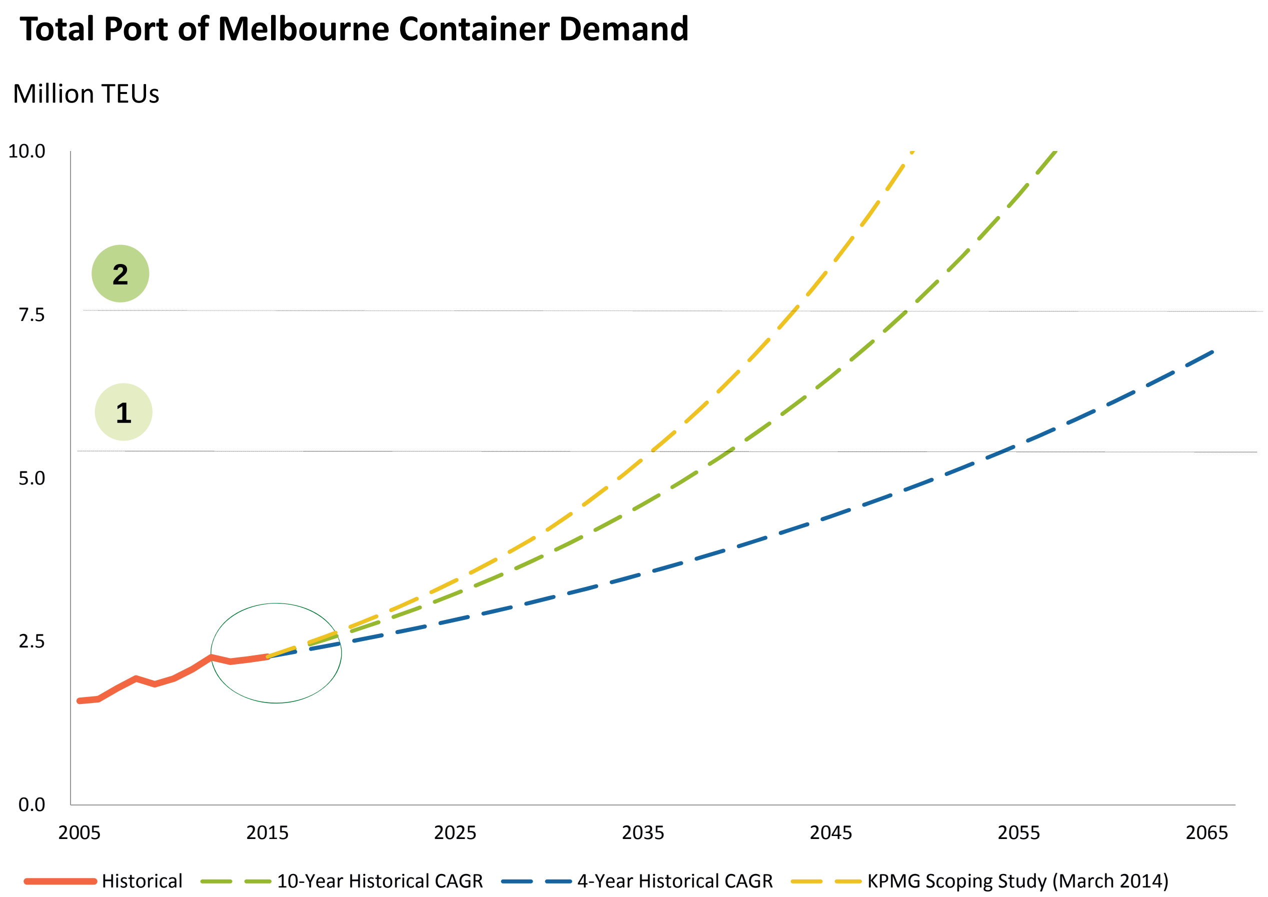
Second container port considerations

Supporting low cost PoM development, while preserving State flexibility to develop a second container port

Timing	• PoM's developable container capacity - consistently estimated between 7-8 m TEUs • PoM's natural developable container capacity can cater for trade growth over next ~30 years • Development of a second container port will be demand driven
PoM capacity maximised	• Low cost source of increased container capacity to meet trade demand until exhausted • Defers State funded high cost greenfield port and flow through supply chain impacts
PGR is necessary	• Align leaseholder's interests with the State to maximise natural container capacity of PoM • Very low likelihood of payments, if any, being made – and is within State control • If second port triggers PGR, State also receiving offsetting revenues from second port • To price and assess demand risk, leaseholder requires: certainty, recognition of upfront value paid, alignment of interests for efficient capacity development and State not frustrating development (noting statutory approvals remain) • Best overall economic State outcome through regime contested in competitive process
State controls and visibility	• Leaseholder to provide periodic development plans to allow State consultation and engagement in responding capacity growth for container trade • Series of gates to be satisfied prior to triggering any payments

Second container port - timing



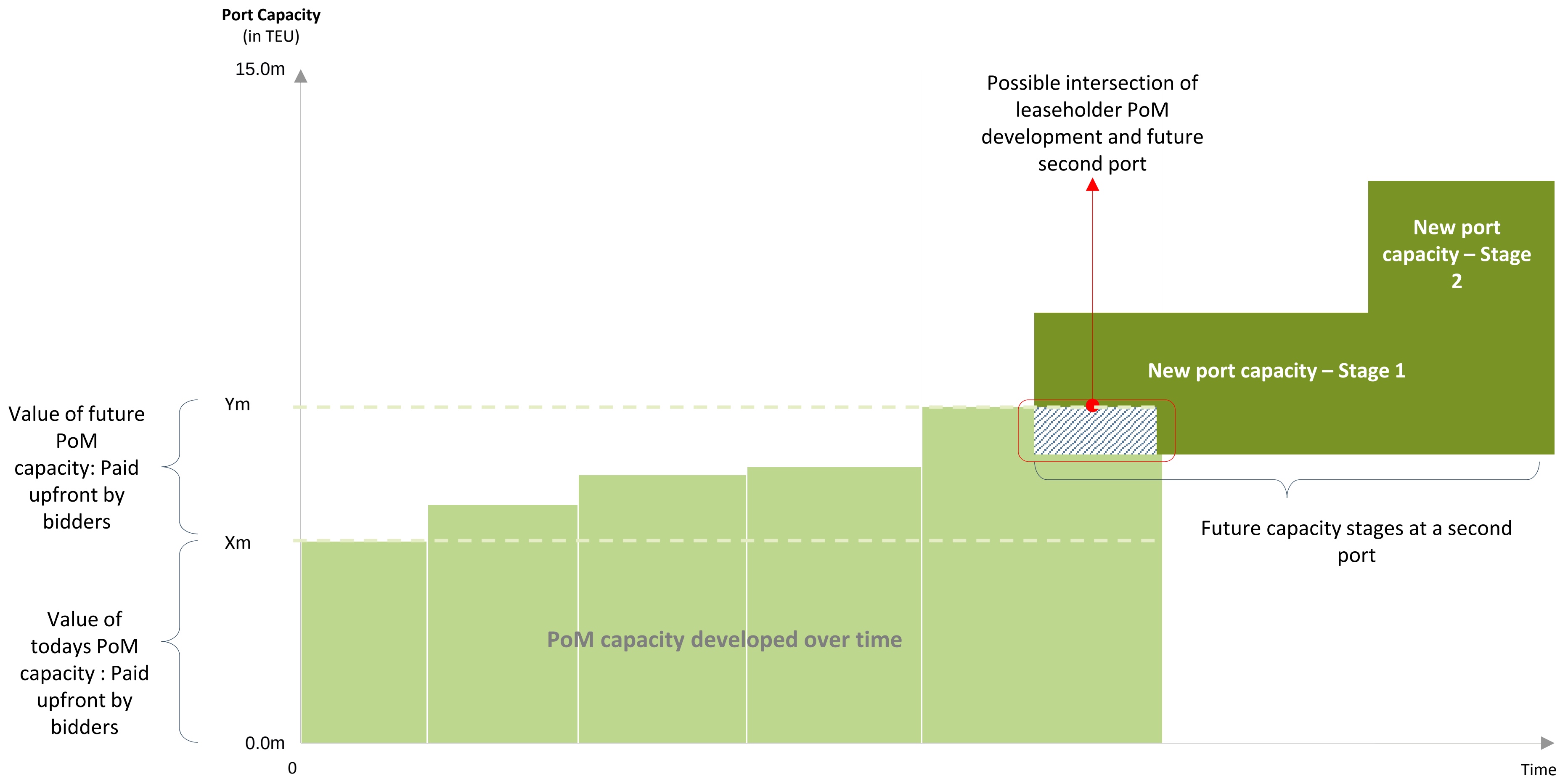
1 Capacity post Port Capacity Project (Webb Dock)

2 Indicative future PoM capacity estimate: 'natural capacity'

Second container port – PGR conceptual value

Conceptual PGR value – optionality framework

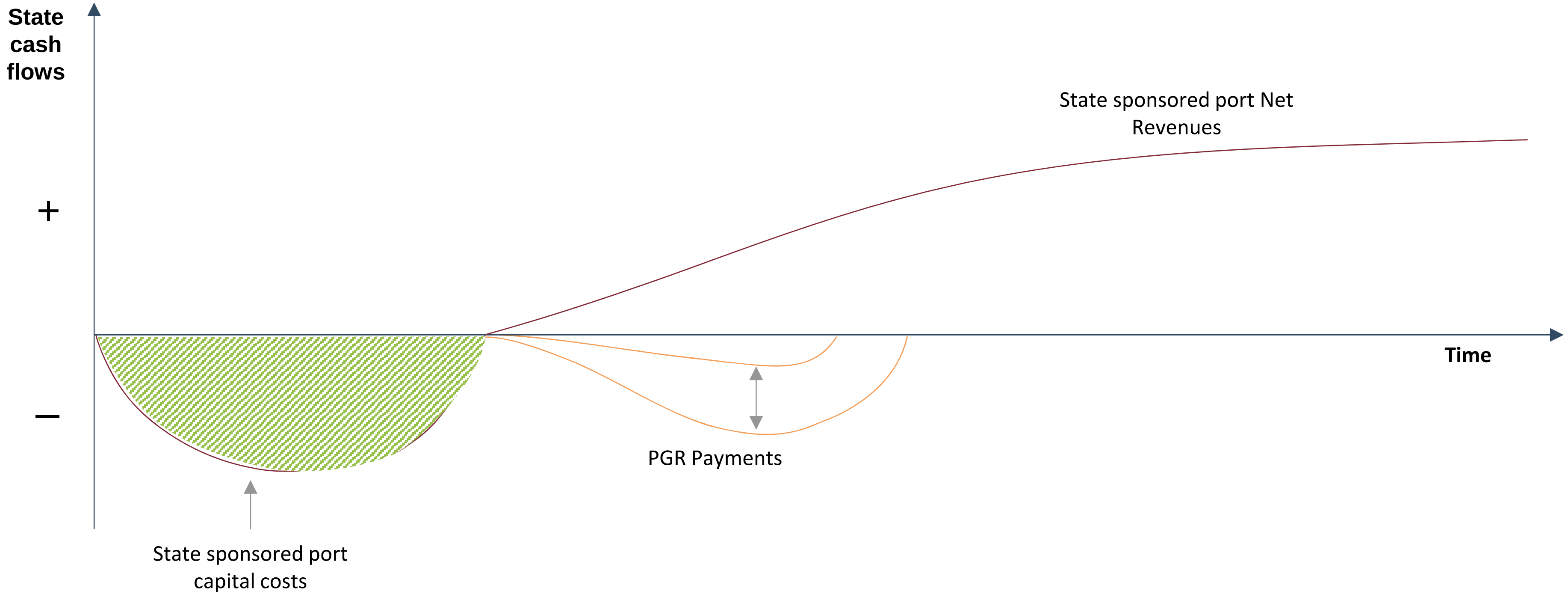
Overlay between PoM and State Sponsored Facility



Second container port – PGR and second port development

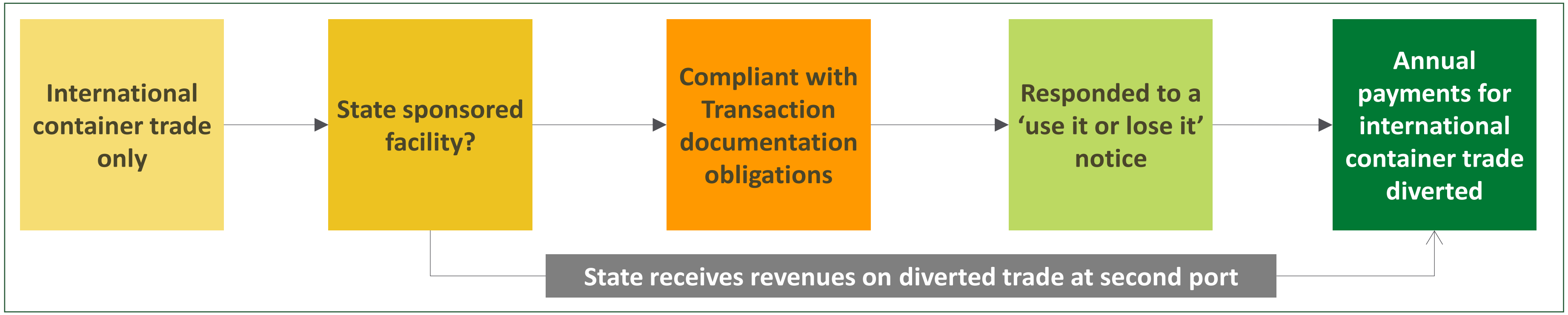
State perspective – PGR and second port development

Illustrative only



Port Growth Regime – Risk Allocation

PGR aligns the State's and leaseholder interests to maximise PoM capacity ahead of the development of a second container port



Risk	Allocation
Container market grows more quickly or slower than expected (i.e. demand risk)	Leaseholder
Non-container trades relocate from PoM	Leaseholder
Container market share lost to a privately sponsored port or remote Victorian port	Leaseholder
Costs of new expansions at PoM are greater than expected	Leaseholder
Capacity fails to materialise as expected when developed or is less efficient	Leaseholder
Standard planning, environmental and other approvals for new container capacity	Leaseholder
Force majeure events	Leaseholder
Leaseholder fails to build new capacity and State is required to invest	Leaseholder
General changes in State laws not specific to PoM, including planning and environmental	Leaseholder
International containers able to be accommodated at PoM diverted to State-sponsored port	**State**

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Balancing short and long-term objectives

Focus is maximising the State's overall economic outcome

State strategic flexibility	• Proposed 50 year lease term reflects need for strategic flexibility (long-term) vs upfront value • State retains strategic flexibility to develop a second port when required. Unfettered ability for State to increase port capacity
Aligning capacity growth incentives	• The Port Growth Regime seeks to align interests of State and leaseholder in efficient and timely development of PoM, but also provides greater certainty to bidders (upfront value)
Maintaining economic efficiency and competitiveness	• Strengthened ESC oversight over broader range of services, with prices capped at CPI for 15 years and export pricing discount preserved