New South Wales
TREASURY

SUBMISSION TO PUBLIC ACCOUNTS COMMITTEE

INQUIRY INTO PUBLIC-PRIVATE PARTNERSHIPS

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List of Acronyms

CAPM	Capital Asset Pricing Model
EP&A Act	Environmental Planning and Assessment Act 1979
JV	Joint Venture
PAC	Public Accounts Committee
PAFA Act	Public Authorities (Financial Arrangements) Act 1987
PFP	Privately Financed Project
PIR	Post Implementation Review
PPP	Public Private Partnership
PSC	Public Sector Comparator
VFM	Value for Money
WACC	Weighted Average Cost of Capital
WWG	*Working with Government* Guidelines for Privately Financed Projects

SUBMISSION TO PUBLIC ACCOUNTS COMMITTEE INQUIRY INTO PUBLIC PRIVATE PARTNERSHIPS

1 EXECUTIVE SUMMARY

Policy frameworks and practices regarding private investment in public infrastructure

- NSW and other Australian jurisdictions have issued guidelines in the last five years regarding private sector investment in public infrastructure. Notwithstanding some technical or terminology differences, Australian jurisdictions are moving towards consistency in policy frameworks and practices in the procurement of privately financed projects. This is reflected in the effort to develop standard commercial principles for PFP contracts.
- Several important principles underlie the NSW Government's policies with respect to private investment in public infrastructure:
  - The *investment* decision (i.e., whether or not the Government will invest in a project) precedes, and is distinct from, the *procurement* decision (i.e., how a project will be financed, once the Government has decided to invest in that project). In the first instance, the investment decision is based on the project being consistent with the Government's strategies and objectives; being subjected to benefit-cost analyses, Gateway reviews and other requirements for establishing a business case; and consequently, being prioritised in the Government's investment plan.
  - Only after a project passes these hurdles is it considered for alternative methods of procurement. The Government does not use PFP procurement as an end in itself, but subjects proposals to a rigorous value for money test to determine whether a PFP form of procurement can generate additional benefits.
  - It is the inherent risks of the individual project that determine the real cost of finance, and these risks remain the same whether the project is financed from Government or private debt. It is a myth that private finance is more expensive than Government debt for purposes of financing a project. Rates on Government debt appear cheaper than on private debt solely because Governments have the power to levy taxes to repay their borrowings. Government borrowing rates do not explicitly price in project-specific risks, whereas private financing rates do.
  - PFPs are <u>not</u> about achieving off-balance sheet financing for infrastructure and services. When engaging the private sector to finance social infrastructure assets, the Government is effectively substituting one form of liability (balance sheet debt) for another (the ongoing commitment to make payments to the operator). This commitment is normally recognised on the General Government sector's balance sheet.
  - For this reason, there is a critical distinction between "funding" and "financing" of a project. A project may be privately *financed,* but service payments to the private party would still be *funded* out of the State Budget, particularly for social infrastructure projects.
  - It is a myth that the private sector earns abnormally high rates of return on privately financed projects. Toll road operators are projected to earn between 13% and 16% after-tax return on investment, which includes design and construction risk (i.e., the assets are

not yet built). This is consistent with pricing regulators in NSW and Queensland, for example, allowing for returns on equity in the range of 10-12% after tax for assets that already exist.

Evaluating and monitoring private investment in public infrastructure

- PFP procurements are driven by Value for Money (VFM) considerations. Value for money in PFPs is determined by a comparison of the Public Sector Comparator (PSC) with private sector bids. In simple form the PSC presents what the Government considers it would cost to do the project itself, including consideration of risk. The components of the PSC and the manner in which it is used are documented in PFP guidance material.
- The PSC is only one of a number of criteria used to evaluate PFP bids. While the use of a PSC is unique to privately financed projects, other criteria (technical, operational, maintenance, legal/commercial, social and financial) used in PFP bid evaluation are equally important in determining value for money.
- Unsolicited proposals are subject to the same due diligence and discipline as Government-sponsored proposals.
- The private sector has raised issues relating to bid costs and planning approvals in the procurement process, which the Government is addressing. Commonwealth taxation is also a threshold issue for private bidders, but is outside the control of the State Government.
- PFPs are monitored through a number of mechanisms, including project management structures, contract summaries, post implementation reviews and reporting of prospective PFPs in the annual State Budget.

Framework for risk assessment and allocation

- Optimal risk allocation is a primary driver of value for money in privately financed projects.
- Current guidelines require comprehensive risk identification, assessment, and preparation of risk response strategies. This process generates information which is used, among other things, in the construction of the Public Sector Comparator and the development of risk management plans for the project.
- The Government has maintained a considered approach to risk allocation, while at the same time developing standard commercial principles to provide a more transparent basis for the allocation of risk and the pricing of bids.

Knowledge sharing across and between agencies

- The main conduits for knowledge sharing on PFPs are the NSW Treasury, specialist technical advisers, and inter-jurisdictional forums or working groups.
- The exchange of knowledge on PFPs between agencies is encouraged and facilitated. However, there may be limited opportunities for exchange during the course of project development, particularly in regard to project details that are commercial in confidence.
- There remain a number of mechanisms for exchange of information about PFP procurement that is publicly available– e.g., Treasury guidance material; contract standardisation/commercial principles; contract summaries.

Management of Intellectual Property (IP) issues

- IP issues in the context of PFPs have arisen mainly in relation to unsolicited proposals.
- The Government's IP Guidelines for unsolicited private sector proposals submitted under the *Working with Government* Guidelines are available on the website: http://www.treasury.nsw.gov.au/wwg/intellectual.htm.
- For agencies to appropriately manage IP matters, it is essential for them to clearly identify IP aspects of project proposals and key project phases that are open to market testing.
- Where a proposal is market tested, Government makes every effort to avoid compromising IP, but must rely heavily on the proponent to supply the relevant IP information.
- To date, Treasury is not aware of any IP issues that have arisen in PFP procurement, and confidential matters are identified and agreed between parties.

Conclusion

- PFPs tend to be large in scale and complex in terms of service delivery and financial arrangements. PFPs are one of many possible models of procurement for public sector infrastructure. For historical and policy reasons relating to the role of Government in the provision of public services, such projects are unlikely to account for the bulk of the NSW public sector capital program in the foreseeable future.

- Nonetheless, PFPs to date have achieved a number of desirable outcomes, most notably:
  - on-time and on (or below) budget delivery of major new assets, while at the same time
  - in the case of economic infrastructure, achieving full transfer of market risk to the private sector;
  - introducing incentives/mechanisms to achieve project outcomes (eg, better quality of service) that may not be achievable under traditional procurement, particularly for social infrastructure.

- The Government will continue to use PFP procurement provided that this yields value for money to the NSW taxpayer. In assessing value for money, it is important to distinguish between social infrastructure and economic infrastructure.

- PFPs have enabled, and will continue to enable in future, the NSW public sector to provide assets and services which it may not be possible to provide in the same time frame and/or to the same service standard under traditional procurement.

2 BACKGROUND

SUMMARY:

- *NSW and other Australian jurisdictions have issued guidelines in the last five years regarding private sector investment in public infrastructure.*
- *Privately financed projects are one form of procurement evaluated by Government.*
- *Notwithstanding some technical or terminology differences, Australian jurisdictions are moving towards consistency in policy frameworks and practices in the procurement of privately financed projects. This is reflected in the effort to develop standard commercial principles for PFP contracts.*

This section responds to Item (a) of the PAC terms of reference, i.e.,

> ***(a) New South Wales, Australian and international legislative and policy frameworks and practices regarding private sector investment in public infrastructure.***

NSW accounts for roughly 40% of the total capital value of privately financed projects (PFPs) Australia-wide. Privately financed projects in NSW are not new. In the 15 years prior to 2001, a total of $5.6 billion was spent on about 24 such projects. Since the issue of the current set of policy guidelines on PFPs in November 2001, over $6 billion worth of public infrastructure have been or are being delivered as PFPs in NSW, of which about $3.8 billion has been awarded for nine more projects.

2.1 Practices in NSW

NSW policies and practices regarding privately financed projects are embodied in *Working with Government: Guidelines for Privately Financed Projects* (hereafter referred to as "WWG").

WWG consolidated into a single guidance document, and effectively replaced, a number of previous issuances including Treasury circulars. WWG also incorporated Government responses to a Parliamentary Accounts Committee (PAC) on infrastructure management and financing in New South Wales, which was completed in 1993-94[1].

WWG had its origins in a Heads of Treasuries review of privately financed projects. The HOTs working party evolved into a regular forum of exchange of information among jurisdictions, culminating in the creation of a National PPP Forum at Ministerial level. WWG was initially issued publicly as a green paper, then subsequently amended and issued as a white paper taking into account comments received from submissions and public consultations. The Government issued the final version of WWG as official guidance material in November 2001.

[1] Public Accounts Committee, *Infrastructure Management and Financing in New South Wales*, PAC Report No.73 (Volume 1), July 1993 and PAC Report No.80 (Volume 2), February 1994.

The statutory basis for WWG is the *Public Authorities (Financial Arrangements) Act 1987* (hereafter referred to as the PAFA Act), which provides for certain financial arrangements (including investments) by public authorities.

WWG provides guidance on the framework and process to enable the public and private sectors to work together on improving public service delivery through private sector provision of infrastructure and related non-core services. WWG describes a competitive and transparent mechanism to govern the procurement of privately financed projects, and the principles or "rules of the game" under which such procurements are conducted.

While WWG had precedents in terms of PPP guidelines (for instance, NSW had previously issued guidelines on private financing of public infrastructure in 1988 and then again in 1995), WWG introduced innovations not found in previous guidelines, in terms of:

- drawing the distinction between core and non-core services;
- requiring Cabinet-level approval at specific stages of PFP procurement;
- providing explicitly for social infrastructure (previously, most NSW PFPs had been for economic infrastructure); and
- introducing the value for money principle in determining whether a project should be procured as a PFP.

The NSW Treasury supports the project development process and facilitates the Government's consideration of projects under WWG. However, ultimately a successful project needs the full commitment and leadership of the relevant service agency, and project outcomes are best specified and managed by the service agency.

2.2 Practices in Other Australian States and Overseas

The PPP concept has gained greater credence in Australia as governments of all levels have discovered the benefits associated with public-private cooperation on the provision of public infrastructure.

In the past five years, all Australian jurisdictions have issued policy documents governing the identification, establishment and operation of public-private partnerships (PPPs). Victoria was the first to issue its guidelines under its *Partnerships Victoria* initiative[2]. Soon after, NSW issued its WWG Guidelines. Other States followed. All the guidance material issued by the various jurisdictions had their origins in principles developed by the Heads of Treasuries working party.

The governing principles or framework adopted by the different jurisdictions are tailored to their respective circumstances and policy preferences, contain various technical and terminology differences, and followed slightly different processes of development. Nonetheless, there has been a convergence towards consistency of principles and practices across jurisdictions in recent years. This benefits both the public and private sectors by way of increased certainty and lower

[2] More detail on this initiative is available through the "Partnerships Victoria" link in the home page of the Victorian Department of Treasury and Finance website http://www.treasury.vic.gov.au/.

transaction costs. For example, PPP procurement tends to be used only for projects large enough to justify incurring associated administrative, bidding, or contract management costs[3].

PPPs by Australian Governments have been heavily influenced by the *Private Finance Initiative* (PFI)[4] in the United Kingdom, which was introduced by the UK Government in 1992 to promote the use of private sector expertise and finance in public sector infrastructure projects[5]. The PFI is strongly orientated towards social infrastructure. The PFI has been particularly influential on Australian practices in terms of contract standardisation, the development and use of the Public Sector Comparator (PSC), and differentiating between core and non-core services.

NSW differs from both the Victorian and UK models in that NSW PFP policies and practices differentiate clearly between *social* and *economic* infrastructure PFPs. (Appendices 2, 3 and 4 of this submission provide descriptions of NSW social infrastructure PFPs for education, health and housing, respectively. Appendix 5 provides a description of PFP-type activities with respect to ports.)

There are many other models of PPP arrangements in the USA, Europe, other OECD countries and developing countries. However, these have had little influence on practices in Australia due to their significantly different underlying statutory frameworks, institutions, or public preferences.

2.3 Different Forms of PPPs

The terms "*public-private partnership*" (PPP) and "*privately financed project*" (PFP) are often used interchangeably by various commentators, and even by some public sector agencies. However, there is a difference between the two.

- "PPP" is a general term which can refer to any contracted relationship between the public and private sectors to produce an asset or deliver a service.
- A "PFP" is a very specific form of PPP which involves the creation of an asset through private sector financing and ownership control for a concession period (usually long term). The Government is willing to contribute through land, capital works, risk sharing, revenue diversion or purchase of the agreed services.

A "PFP" covers Economic Infrastructure or Social Infrastructure, and typically includes both a capital component and an ongoing service delivery component. PFPs are generally complex and

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3 For example, in QLD the PPP framework does not apply if the capital value of a project is $30 million or less, or its net present value (NPV) does not exceed $50 million. In VIC, NSW, NT and ACT, there is an explicit presumption that the project will generally not satisfy the value for money test unless it has a total contract value (in NPV terms) of more than $10 million (VIC) or $20 million (NSW, NT, ACT), or can be bundled together with similar projects to reach that threshold.

4 Various documents describing the genesis of the PFI and key guidance documents governing the conduct of PFI projects (eg, standardisation of PFI contracts, value for money appraisal, credit guarantee finance arrangements) can be found in the "Public-Private Partnerships" link on the UK Treasury website: http://www.hm-treasury.gov.uk/index.cfm.

5 The PFI in the UK was a response to a long term and pronounced decline in public sector net investment since the 1970s, resulting in falling standards in schools, hospitals and other public service assets. Although Australia did not suffer the same degree of decline in quantity or quality of public investment as the UK, the disciplines and commercial principles developed under the PFI nonetheless provided a viable model for Australian jurisdictions.

involve high capital costs, lengthy contract periods that create long term obligations, and a sharing of risks between the private and public sectors. They therefore require careful consideration and approval by the Government.

Other forms of project delivery structures that should be distinguished from PFPs are:

- *Design-Build (DB) or Design-Build-Operate-Maintain (DBOM)* – these are forms of PPP which differ from PFPs in that they do not entail the provision of private financing. The Junee Correctional Centre is an example of a DBOM project.
- *Joint Venture (JV)* – The PAFA Act defines a JV as an activity: (a) carried on jointly by two or more persons, whether or not in partnership, or (b) carried on by a body corporate formed by two or more persons for the purpose of enabling those persons to carry on that activity jointly by means of their joint control, or by means of their ownership of shares in the capital, of that body corporate. An activity may be regarded as carried on jointly even though some or all of the persons involved carry on different aspects of the activity[6]. The Victoria Park Redevelopment and Sunshine Electricity Co-Generation Plants are examples of JVs.

  A JV entails participants sharing *ex post* in the costs, risks and benefits that arise from the project. It differs from a PFP in that the latter entails participants allocating *ex ante*, via explicit contractual arrangements, the risks, costs and benefits of the project. On balance, a JV therefore carries a higher probability of risk to the public sector. This is why one of the ground rules for PFPs is that the Government will not guarantee private sector borrowings and will not take an equity share-holding, although the Government may contribute land, capital works or some form of revenue diversion.
- *Project Alliancing* – this structure is usually formed between the owner and one or more non-owner parties who collectively bring (in-house) the critical resources needed to deliver the project. There are many hybrid forms of alliancing, but the typical form entails the partner organisations joining to share risks and rewards for the duration of the project, through equity shareholding in a common commercial vehicle[7]. Sydney Water's Northside Storage Tunnel Project in the late 1990s is an example of a project alliance[8].

  A key feature that distinguishes an alliancing arrangement from other organisational forms of project delivery is that there is collective sharing of all project risks; no fault, no blame and no dispute between the alliance participants; and no legal recourse against non-owner parties in the event that things go wrong. Consequently, it is difficult to demonstrate value for money where the owner and the other parties develop and agree the terms of the arrangement and performance targets in the absence of price competition.

WWG Guidelines cover PFPs only. Other types of PPPs are dealt with by the NSW Government Procurement Guidelines, which are outside the scope of this submission. Descriptions of policies and practices from section 3 onwards in this submission refer mainly to PFPs, as this is the type of PPP specifically governed by the WWG Guidelines.

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6 "Joint Venture" refers to the organisational relationship between the parties involved rather than to the type of activity being carried out (eg, design, construct, maintain, finance, and so on). Thus, it is possible to have a JV delivering activities ranging from a traditional Design-and-Construct contract to a build-own-operate-transfer project or its variants.

7 Marton Marosszeky, "Institutionalising Alliances in Construction Projects", Paper prepared for the University of New South Wales, 2002.

8 For more detail on the Northside Storage Tunnel Project, see the Auditor General's *Report on the Performance Audit of the Northside Storage Tunnel Project*, July 2003.

3 EVALUATION AND MONITORING OF PRIVATE INVESTMENT IN PUBLIC INFRASTRUCTURE

SUMMARY:

- *PFP procurements are driven by Value for Money considerations. VFM in PFPs is determined by a comparison of the Public Sector Comparator (PSC) with private sector bids. The components of the PSC and the manner in which it is used are documented in PFP guidance material.*
- *The Government does not use PFP procurement as an end in itself. Several important principles underlie the NSW Government's policies with respect to private investment in public infrastructure:*
  - *A clear distinction is drawn between the investment decision (i.e., whether or not the Government will invest in a project) and the procurement decision (i.e., how a project will be financed, once the Government has decided to invest in that project).*
  - *It is the inherent risks of the individual project that determine the real cost of finance, and these risks remain the same whether the project is financed from Government or private debt. Government borrowing rates do not explicitly price in the cost of project-specific risks, whereas private financing rates do.*
  - *PFPs are <u>not</u> about achieving off-balance sheet financing for infrastructure and services. When engaging the private sector to finance social infrastructure assets, the Government effectively substitutes one form of liability (balance sheet debt) for another (the ongoing commitment to make payments to the operator).*
  - *Consequently, there is a critical distinction between "funding" and "financing" of a project. A project may be privately financed, but service payments to the private party would still be funded out of the State Budget, particularly for social infrastructure projects.*
  - *It is a myth that the private sector is earning abnormally high rates of return on privately financed projects. For instance, the projected 13% to 16% return after tax on investment, which includes design and construction risk (i.e., the assets are not yet built), is consistent with pricing regulators in NSW and Queensland who allow for returns on equity in the range of 10-12% after tax for assets that already exist.*
- *The PSC is only one of a number of criteria used to evaluate PFP bids. While the use of a PSC is unique to PFPs, other criteria (technical, operational, maintenance, legal/commercial, social and financial) are equally important in PFP bid evaluation.*
- *Unsolicited proposals are normally subject to the same due diligence and discipline as solicited proposals.*
- *The private sector has raised issues relating to bid costs and planning approvals in the procurement process, which the Government is addressing. Commonwealth taxation is also a threshold issue for private bidders, but is outside the control of the State Government.*
- *PFPs are monitored through a number of mechanisms, including project management structures, post implementation reviews, contract summaries, and reporting of prospective PFPs in the annual State Budget.*

This section responds to item (b) of the PAC terms of reference, i.e.,

> ***(b) Government models for evaluating and monitoring private investment in public infrastructure.***

In regard to evaluation of PFPs, section 3.1 describes the broad principles and the tools used in the value for money assessment.

Section 3.2 describes some factors affecting PFP procurement (eg, Commonwealth taxation issues, planning approvals, bid costs).

Section 3.3 deals with the mechanisms for monitoring of PFPs (project management structures, contract summaries tabled in Parliament, Post Implementation Reviews, and budgeting and accounting for PFPs in the State's financial records).

3.1 Evaluation of Private Investment in Public Infrastructure

Important underlying principles

There are several key principles that govern NSW practices in the evaluation of private investment in public infrastructure.

Investment Decision vs Procurement Decision

Government policy distinguishes between:

- The *Investment* Decision – i.e., is this a "good" project which the Government would be willing to invest in, irrespective of the method of financing? The investment decision (to proceed with a project) must be supported by a Business Case, including Gateway reviews. A key part of the Business Case is the economic and/or financial appraisal which demonstrates the basis for the preferred option – i.e., that option where economic or financial benefits exceed its costs, or is the most cost effective solution (if project benefits are equivalent for all options considered). The project should also be shown to be consistent with the Government's priorities and the agency's own service delivery objectives. As a result of the investment decision, a project is included in the Government's investment plan and funding for the project is reviewed as part of the annual budget.

- The *Procurement* Decision – Only after a project passes the hurdles of the investment decision is it considered for alternative methods of procurement – i.e., whether by the traditional delivery model or through a PFP. This decision is based on a Value for Money assessment (see section 3 for more details on VFM assessment applied to PFPs).

WWG Guidelines require Government approval for the investment decision, and for the procurement decision if the project is a PFP.

PFP requirements at the procurement stage tend to be more stringent than those for conventional procurement. The reason for this is the long-term nature of the concession period, involvement of the private sector and interface with the public sector, and consequently, the likelihood of greater risks associated with the project. This means the Government must identify and allocate more risks than are normally identified under a conventional procurement contract.

Value for Money (VFM)

When evaluating various procurement alternatives, the Government focuses heavily on value for money. The decision rule is that the Government will not use PFP procurement unless it delivers value for money to the State, which means getting the best possible outcome at the lowest possible price. Value for money may arise from a number of factors:

(a) Integration of service delivery and whole-of-life costing

A PFP provides value for money by integrating upstream aspects such as design and construction with downstream aspects such as operations and maintenance. For example, in the New Schools Phase 1 project, the private sector was responsible for design, construction, and through-life support for the schools. By bundling these responsibilities, the private sector party is encouraged to develop and apply innovative solutions that reduce the level of upstream and downstream costs, maximise upstream and downstream interface, and meet the service requirements. (See Appendix 2 for more details on the New Schools project.)

(b) Innovation

A PFP arrangement incentivises the private sector to minimise costs whilst meeting the State's service requirements. Bidders seek to develop and apply innovative solutions, therefore reducing their input costs and making their bid more attractive to the Government. In addition, throughout the concession period the successful consortium has the incentive to maximise innovation as the payment regime for the PFP is normally performance-based, not input-based.

(c) Potential for efficient transfer of risks to the private sector

This is discussed in more detail in Section 4 of this submission.

(d) More efficient asset use and management over the life of the contract

Some PFPs incorporate third-party use of assets, either concurrently or 'out-of-hours', for example, out-of-hours adult education services in schools. Third-party use of assets is a value-for-money driver as the revenue generated from the third-parties reduces the net cost to Government.

Sections 3.1.2 and Section 4 of this submission provides more details on how the Government assesses value for money in PFP proposals.

Private Financing vs Government Debt

Some commentators have raised the issue of why a government would seek to use private sector finance to build infrastructure, when it can borrow at lower interest rates by issuing government bonds.

It is a fallacy that governments have access to cheaper *project finance*. A government's ability to borrow more cheaply is purely a function of its capacity to levy taxes to repay borrowings. Credit markets perceive this power of Governments as reducing the risk of private investors, and are therefore willing to lend to a Government at lower rates than to a private sector borrower. The difference between the private and the public sectors is that private sector capital markets explicitly price in the risk of a project into its sources of finance. This is not the case in regard to the public sector borrowing rate.

In raising finance for a project on a non-recourse basis, it is therefore the risk of the individual project that determines the real cost of finance. That is, the intrinsic risk of the project does not change, irrespective of whether it is financed from public or private sources. A more comprehensive up-front consideration of the costs of these risks to the Government enables a true comparison of the cost of conventionally financed infrastructure with privately financed options.

Funding vs Financing

It is important to note the critical distinction between "funding" and "financing" of a project. A project may be privately *financed,* but service payments to the private party would still be *funded* out of the State Budget.

The distinction revolves around whether or not a PFP provides additional funding on top of what is normally provided in the State capital investment program. This in turn depends on the type of project – i.e., whether it is a Social Infrastructure PFP or an Economic Infrastructure PFP.

- In the case of *social* infrastructure, PFP procurement normally does not generate additional funding over and above what is provided in the State capital program. Potential social infrastructure PFPs must be approved and funded for, using conventional procurement methods, before a decision is taken to use PFP procurement on value-for-money grounds.

- *Economic* infrastructure, however, has the potential to add to the pool of resources for capital investment. Such projects are generally funded by third party revenues (user charges) and may not require net additional funding from the Government's consolidated revenue. To the extent that economic infrastructure PFPs top up existing resources, this frees up capital resources and gives the Government the capacity to bring forward capital expenditure which it might not otherwise have undertaken.

On-Balance Sheet vs Off-Balance Sheet

It is emphasised that PFPs are <u>*not*</u> about achieving off-balance sheet financing for infrastructure and services. When engaging the private sector to finance social infrastructure assets, the Government is effectively substituting one form of liability (balance sheet debt) for another: the ongoing commitment to make payments to the operator (which may or may not be recognised on the General Government sector's balance sheet).

For NSW, obtaining off-balance sheet treatment is not an attraction in its own right. The payment commitments of a PFP are as real as those associated with servicing balance sheet debt and, in the context of the Government's fiscal strategy, need to be considered in a similar manner.

Ratings agencies have made it clear that their assessment of the Government's credit rating takes into account all its forward financial obligations, including payment commitments for privately financed assets, whether or not they are recognised on the General Government sector's balance sheet.

The Public Sector Comparator (PSC)

Attributes of a PSC

The PSC is a measure of what it would cost the Government to deliver the project itself, and includes a full *ex ante* estimated cost of the project. The PSC is normally prepared at an early stage of procurement – usually before or immediately after a Request for Detailed Proposals is issued, and before detailed proposals are received.

The PSC represents the most efficient likely true cost to the State of meeting the technical and service specifications of the project under a traditional public procurement. The PSC therefore provides a consistent benchmark for assessing bids, and is intended to encourage bidders to put forward the most efficient bid.

Important considerations taken into account in constructing the PSC include the specification of outputs and performance levels (including the determination of key performance indicators against which service delivery will be monitored), the allocation and cost of various risks, and the comprehensiveness of cost estimates. Ultimately, the PSC serves as a means of demonstrating likely VFM as well as a management tool during the procurement process.

The PSC is expressed in net present value terms, with projected cash flows discounted using an appropriate discount rate. The PSC is costed on a whole-of-life basis, and includes capital and operating costs expected to be incurred over the life of the Project.

The choice of discount rate is based on the Capital Asset Pricing Model (CAPM), and follows guidance material developed jointly by the Commonwealth and States and Territories for the determination of appropriate discount rates in evaluating private financing proposals[9].

Components of a PSC

The core components of the PSC are as follows:

1. Raw PSC – This is the base cost of delivering the project, and is usually derived from the internal financial records of the service agency.

2. Competitive neutrality adjustments – This puts the project on the same basis as the private bidder, and comprises adjustments to remove any advantages/disadvantages (usually relating to taxation) that accrue to the State by virtue of its public ownership.

3. Risk adjustments – the PSC is prepared on the basis that all relevant risks are costed into the expected value of the cash flows. It is essential to identify all potential risks; and to quantify

[9] See paper jointly developed by Commonwealth and States and Territories on *Determination of Appropriate Discount Rates for the Evaluation of Private Financing Proposals*, 7 June 2002. The paper was commissioned by the Commonwealth. The CAPM framework is based on the theory that investors will price assets so that the expected return is equal to a risk-free rate of return, plus a risk premium that is proportional to a measure of the risk ('beta') associated with the project.

as realistically as possible the likelihood of the risk occurring and the cost that would be incurred if the risk were to crystallise over the life of the project. Risks identified in the process of constructing a PSC include:

- Transferable Risks – This is the value of those risks which the State would bear under a public procurement, but is likely to allocate to the private sector under a PFP delivery model. These costs are added to the PSC to reflect the full costs associated with traditional public procurement.
- Retained Risks – This is the value of those risks that are likely to be retained by the State. This is added to the private sector bids to provide a true basis for comparison.

A distinction is made between retained and transferable risks because the latter, if accepted by the private sector, will be expected to carry a price premium that would be reflected in the tenders.

The construction of the PSC is a key step in the assessment, allocation and management of risks for the project (see section 4 below for more details on risk allocation).

Due to their different attributes, there are differences in the way the PSC is constructed for Social and Economic Infrastructure projects. Table 1 illustrates the major differences.

Table 1: Constructing a PSC for Economic and Social Projects

Model	**Social Infrastructure**	**Economic Infrastructure**
Key Differences	▪ No market risk transferred to private sector ▪ Cost risk is a key driver ▪ Usually implemented by a General Govt Agency	▪ 3rd party revenue (market risk) transferred to private sector ▪ Revenue risk is a key driver ▪ Corporations delivery model
Competitive Neutrality	▪ State Taxes	▪ State Taxes ▪ Commonwealth Taxes
Risk Valuation	▪ Cost risk valued and included in cash flow ▪ All risks identified	▪ Cost risk valued and included in cash flow ▪ Equity priced off listed infrastructure products, which reflect market risk ▪ Debt = TCorp + guarantee fee
Raw Project Costs	▪ Capital ▪ Operating costs ▪ Maintenance ▪ Whole of life Costing	▪ Capital ▪ Operating costs ▪ Maintenance ▪ Whole of life Costing

Use of the PSC in the evaluation process

The PSC is used to assess whether a given PFP yields value for money compared with traditional procurement.

Value for money assessment is based on a comparison of each bid with what it would have cost the Government to undertake the project itself. Value for money does not necessarily arise from the lowest bid. Rather, value for money should be judged on the basis of the optimum of whole of life cost and service standards (quality) required to meet demand for the service.

The PSC matters as a vital component of the value for money assessment. It is a threshold price which bidders are expected to beat, if the PFP is to deliver value for money.

Importantly, privately financed projects face the same threshold tests as budget-funded projects. That is, they must be socially and economically justified, and in the public interest. In addition, projects earning third party revenues must have a charging and access regime that is both equitable and efficient.

Beating the PSC is therefore a necessary but not a sufficient condition for a winning PFP tender.

Evaluation of PFP bids also takes into consideration all other aspects normally examined in assessing bids for traditionally procured projects, the most important being:

1. Technical aspects
2. Operations
3. Maintenance
4. Legal and commercial aspects
5. Social outcomes
6. Financial aspects

Items 1 to 3 normally deal with the physical aspects of project delivery. Item 4 deals with an assessment of the risks. Item 5 examines social costs and benefits, while Item 5 examines issues such as project viability and financial costs and benefits. The PSC is a major component of the financial evaluation. These criteria are normally assigned various weights in arriving at an overall score and ranking of bids.

Discount Rate

An appropriate discount rate is needed in order to compare the PSC with different private sector bids for the purpose of identifying the best Value for Money option. Apart from broad rules of thumb developed jointly by all Australian jurisdictions in June 2002, there are no fixed rules regarding the discount rate, which is chosen on a case by case basis. For this reason, sensitivity analysis (i.e., calculating the net present value of the project using different discount rates) is essential.

Based on the Capital Asset Pricing Model framework, the "risk-free" rate is assumed to be the Government (NSW TCorp) bond rate. Appropriate discount rates will differ depending on the type of project.

- For *Economic* Infrastructure – the appropriate discount rate is the project's weighted average cost of capital (WACC) – i.e., the average cost of debt and equity weighted respectively by the financing shares contributed by each.

- For *Social* Infrastructure, the PSC is discounted by the NSW TCorp borrowing (risk-free) rate, while private sector bids are discounted by the NSW TCorp borrowing (risk-free) rate <u>plus</u> a margin reflecting the systematic risk that is transferred to the private bidder. Systematic risk is risk which cannot be diversified away, and reflects the extent to which an asset's return varies with returns in the economy as a whole. Non-systematic (project-specific) risk can be diversified away by investors, and is not recognised in the cost of capital. Systematic risk may be retained by Government, fully transferred or shared.

It is a myth that the private sector earns abnormally high rates of return on privately financed projects. For example, toll road operators are projected to earn 13% to 16% return on investment after tax. This return includes design and construction risk (i.e., the assets are not yet built), which normally accounts for a significant part of the risks associated with toll roads. This is consistent with pricing regulators in NSW and Queensland, for example, allowing for returns on equity in the range of 10% to 12% after tax, for transport and water supply assets that already exist[10].

Treatment of efficiency gains

Where savings are realised as a result of using PFP procurement rather than traditional procurement, the service agency retains these savings.

For example, in the New Schools project it was estimated that PFP procurement yielded savings of about $7 million. These savings were retained by the Department of Education and Training and used for other education and training purposes.

Unsolicited proposals

Some PFP proposals, often in property-related areas, are brought to Government without the Government having called for tenders. In many cases, proponents of such projects expect to proceed to direct negotiations over the project. However, in the absence of a competitive process, the Government may not always be in a position to assess whether the proposal represents value for money. For this reason, the WWG Guidelines specifically detail the process and general requirements for dealing with unsolicited proposals.

The general principle is that unsolicited proposals, while offering the potential for innovation, must be subject to the same discipline and due diligence as solicited proposals. They must demonstrate an overall community benefit and be consistent with the Government's plans and priorities. The Parramatta Transport Interchange is one example of a successful unsolicited proposal that was assessed as yielding value for money.

Unsolicited proposals should be sent to the Director-General of the Premier's Department. The Director-General will inform the Proponent of the information required to assess his proposal, coordinate relevant agencies to review and assess the proposal, and set a timetable for reviewing it. The outcome of the review will be a Preliminary Assessment report. The Director-General will inform the Proponent of the outcomes of the Preliminary Assessment. The Government will not reimburse costs incurred by a proponent in developing and presenting a proposal.

The Government may consider promising proposals. However, unsolicited proposals will be competitively tendered, whilst preserving any confidential information and intellectual property, unless it can be demonstrated that:

- The proposal contains intellectual property and direct negotiations will preserve considerable benefits for the agency, the Government and community;
- That direct negotiations would provide better value for money than competitive bidding;

[10] For example, the Independent Pricing and Regulatory Tribunal in NSW, for example, has allowed Sydney Water and Rail track owners a return on equity of 10%-12% in nominal after-tax terms. The Queensland regulator has allowed the Dalrymple Bay Coal Loader a return of 9% weighted average cost of capital in after-tax nominal terms, based on return on equity of 12% in after-tax nominal terms.

- The proponent has the expertise, experience and financial capacity to successfully deliver the project, and that it is not available elsewhere in the market; and

- The monetary value of the intellectual property.

If direct negotiations are approved, a public statement will be issued outlining the reasons for this approach. The proponent will then be asked to submit a detailed proposal for assessment.

Consistent with the WWG Guidelines, proponents of unsolicited proposals must submit the following information in order for a Preliminary Assessment to be adequately made:

- Details to demonstrate overall community benefits of the proposal.
- Details to demonstrate consistency of the proposal with Government plans and priorities.
- Reasons for and the net benefit of not undertaking a competitive tender process, if that is being requested, and that the proponent has the expertise, experience and financial capacity to successfully deliver the project, and that it is not available elsewhere in the market, citing evidence to prove such claims.
- An inventory of any significant intellectual property, the nature of the item (eg copyright, patent, trade mark, design rights) and its value, including any assumptions and evidence used to determine its value.
- Identification of each item of confidential information.
- Details of proposed ownership of assets and rights.
- Proposed risk matrix and risk mitigation strategies.
- A financial appraisal detailing financial feasibility pursuant to the NSW Government Guidelines for Financial Appraisal.
- An economic appraisal demonstrating net economic benefits pursuant to the NSW Government Guidelines for Economic Appraisal.
- Details of all required environmental approvals and issues and the process for managing these matters.
- An outline of construction concepts, describing methodology and feasibility.
- Communications plan.
- Location of proposal and proposals for acquiring any required land.

- Details of who would be the contracting parties, build the infrastructure, operate and maintain the infrastructure.

Probity

Generally, the NSW Codes of Tendering and Procurement are scrupulously followed to ensure a fair consideration of tenders at every step. A number of mechanisms help to ensure probity in the evaluation of PFP bids.

Probity Plan and Appointment of a Probity Auditor

The sponsor agency managing the project prepares a Probity Plan to make clear the procedures it will use to handle matters that may arise in the course of tender submission, proponent briefing, the assessment of proposals and in seeking clarification of submissions, and to assure applicants that no unfair advantages will be given to, or no discrimination will occur against, any one bidder.

A Probity Auditor is appointed to personally monitor the assessment activities and independently validate that the processes have been fairly and equitably executed. Perceived irregularities may be reported to the Probity Auditor at any time by any party. In some cases a separate Probity Advisor may be called upon to advise the Assessment Panel.

Treatment of Bids by Related Companies

At the time expressions of interest are sought and again when proposals are invited, rules by which the submissions are to be assessed are published so that bidders understand –

- what behaviour is expected of them; and
- the predetermined criteria by which tenders are to be assessed.

As discussed in Section 3.2.1, Australia has few large equipment manufacturers and civil construction companies, which presents a risk of tender collusion. This means that the Government must put extra effort into ensuring contestability in tendering processes.

In some industries participating in the market for PFPs, the ownership of firms has become very concentrated and, rarely, there may be common directors of companies involved in the bid competition.

Where so called "Related Company" participants bid, whether involving related organisations or individuals, the Government collects organisational details of bidders. To be considered fit to participate in the general competition, the affected "Related Company" proponents must meet a distinct assessment criterion of preserving effective competition and probity between and within applicants, having regard of the project achieving the objective of best value for money.

Conflict of Interest and Confidentiality declarations

After the participant bidders' identities are known, public servants and assisting technical specialist advisers on tender assessment panels record potential conflicts of interest and give written undertakings to keep confidential matters that they learn in the course of the assessments. Evaluation of written material proceeds in a secure office, and communication between the panel and the participants are normally through a single channel and are meticulously recorded.

Unsolicited Proposals and Direct Negotiations

WWG Guidelines directly address two issues with potential for probity concerns – Unsolicited Proposals and Direct Negotiation. This is discussed in section 3.1.3 of this submission.

Contract Summaries

Contract Summaries, usually about 30-50 pages in length, are prepared by the service agency and tabled in Parliament. The summaries are reviewed and certified by the Auditor General as a reliable account of the final arrangements under the project. Section 3.3.3 of this submission discusses contract summaries in greater detail.

3.2 Factors or Issues affecting PFP Procurement

Bid Costs

Bid costs are the costs incurred by bidding consortia in assembling their bid team, preparing their response to the State's request for proposals, and engaging specialist advisors such as lawyers, engineers, insurance brokers, architects, accountants and ratings agencies. Costs include the allocation of significant internal resources by the projects sponsors to the project team as well as the payment of fees to external advisors. Whilst some costs can be negotiated on a contingency/success basis, the majority of these costs are incurred whether the consortia submits the winning bid or not.

The cost of participating in a bid process can range from a few million to tens of millions of dollars for very large and complex transactions. The Government is well aware of the impost bid costs placed on prospective bidders and is committed to running efficient procurement processes to minimize bid costs while achieving the best value for money outcome for the State.

Bid costs are the unavoidable by product of the procurement of large and complex projects. The Government seeks to establish competitive procurement processes to ensure it receives the best value outcome for the state. To achieve such an outcome it is necessary to:

- have multiple proponents bid on a common project scope
- require a high degree of specification in the bids so that offers can be accurately compared to the scope and to competing offers
- reduce the risk that the proponent's solution, and therefore value for money, will change significantly between bid and contract finalization.

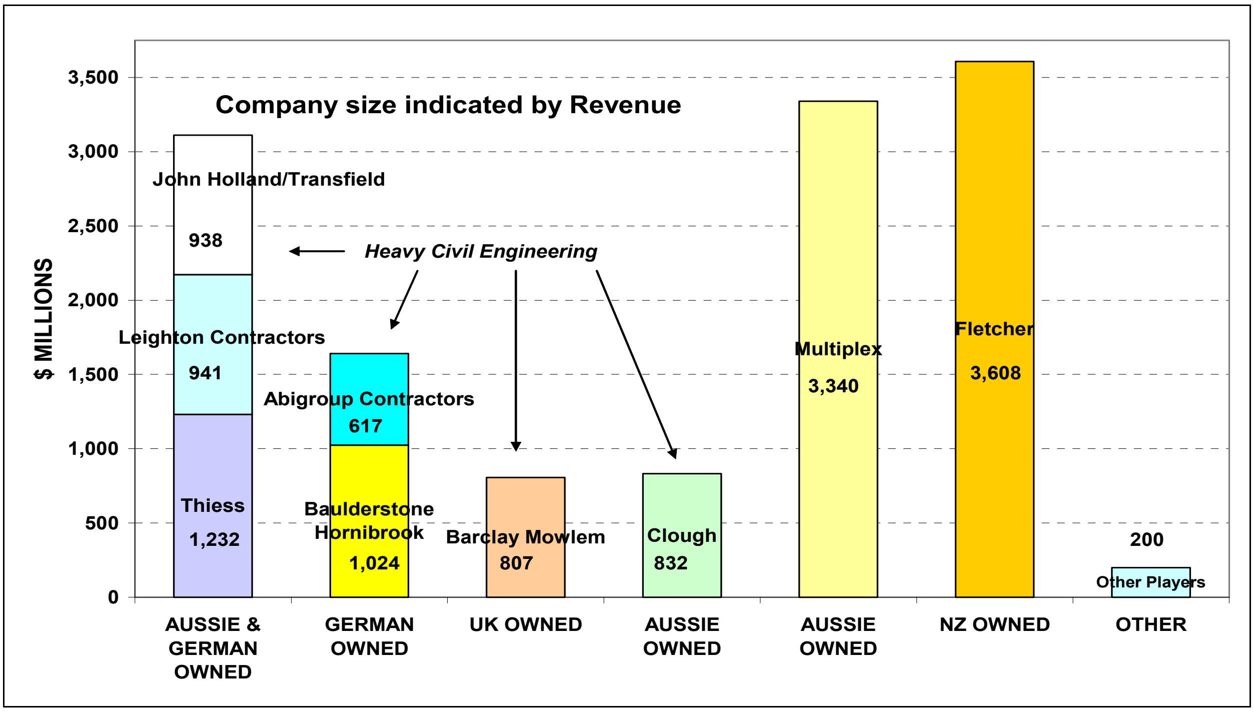
As a result, multiple parties are asked to submit detailed technical and financial proposals to the State on each of these complex projects. Any other approach results in a loss of competitive tension or an increase in risk to the State that the technical and/or financial outcome will differ markedly from what the State thought it had bought.

It should be noted that the public sector also incurs significant costs in the procurement process both in terms of allocation of staff and the engagement of specialist advisors to accurately scope the project and advise on the legal, financial and technical evaluation of the bids.

The problem of achieving a competitive bidding field is exacerbated by concentration in the Australian construction market (Figure 1). The market is characterised by a small number of large contractors with the financial and technical capability to undertake large, complex projects. This concentration has been increasing in recent years (eg the collapse of Walter Construction, the acquisition of John Holland by Leighton).

Given these market constraints, the State has been compelled to introduce bidding procedures to ensure there is a competitive process in place.

Figure 1: Australian Construction Industry



SOURCES: Kingsway, BRW

What Government is doing to address the bid cost issue

Government is aware that these requirements impose significant costs on proponents and has taken measures to minimise bid costs.

- The States have worked together to develop standard PPP commercial principles. There are differences between States on some commercial principles but they have been standardised to the extent possible. Standardisation reduces negotiation from transaction to transaction, reduces the complexity of bidding on similar projects across jurisdictions and increases transparency.
- Government has also increased the level of preparatory work prior to bringing proposals to the market. Increased technical specification and provision of draft contracts in requests for proposals gives greater certainty and reduces duplication of effort for proponents.
- For some projects the State may adopted a two stage tender process for PFPs. This process results in the State taking a minimum number of proponents through to detailed proposal, achieving its objectives of competitive tension and bid specificity whilst reducing bid costs.

Planning Approvals: Recent Amendments to the EP&A Act

Some private parties have in the past raised the issue of the planning approval process creating uncertainties in capital procurements generally. Recent amendments to the *Environmental Planning and Assessment Act 1979* (hereafter referred to as the EP&A Act) could facilitate the delivery of PFPs.

The project approval regime under the EP&A Act provides for infrastructure projects to be assessed on their merits, irrespective of whether they are PFPs or traditionally procured. This assessment takes into consideration land use planning and environmental implications of the projects. Until the project is approved under the EP&A Act, the design, specifications and costings cannot be clearly specified.

To bring forward the clarification of these specifications and hence reduce risks associated with delivering PFPs, provisions have been added to the EP&A Act to provide a tiered approach for the approval of major projects.

These new provisions under Part 3A of the Act provide for earlier assessment and approval of key project parameters under a concept plan approval, with the details of the project left for later assessment and approval. For example, proponent agencies can lodge a concept plan application under Part 3A. This would normally result in the approval of key project parameters such as the site or route and broad project specifications of the project.

Once approved, the agency could then tender for private partners to deliver the project, with the preferred tenderer having to obtain an approval for only the details of the project consistent with the concept approval. This tiered approach limits the uncertainties and risks regarding project parameters, while still allowing the private sector to be innovative in the delivery of the project within the approved project parameters. This approach avoids time delays in obtaining approvals by the private partners, with beneficial cost implications for Government.

3.2.3 Commonwealth Taxation Issues

There are provisions of the Commonwealth income tax law that can be particularly problematic for PFPs. The relevant provisions (the so-called “leasing provisions”) that affect PFPs most significantly are Division 16D and Section 51AD of the *Income Tax Assessment Act 1936.*

Section 51AD applies to property that is predominantly financed by non-recourse debt (i.e. for which the lender has security against only the project’s assets); and is leased to, or “effectively controlled” by, an end user which is a tax-exempt entity (including a Government). Section 51AD completely disallows deductions relating to the property, while all the income remains taxable. A PFP to which section 51AD applies is tax disadvantaged relative to a conventional public sector delivery option. This makes it highly unlikely for the Government to obtain value for money in a PFP that is subject to Section 51AD.

Division 16D applies to a “qualifying arrangement” where Section 51AD does not apply, and where there is “use or effective control” by an end user that is a tax-exempt public body. Division 16D re-characterises the transaction as a sale-and-loan arrangement. A private provider of a PFP to which Division 16D applies would be denied ownership-related tax deductions (predominantly depreciation), but would be taxed only on the “interest component” of the payments it receives from the Government.

Because the application of 51AD and 16D is determined by the Commissioner of Taxation based on the project’s fundamental characteristics and financial arrangements, it is not self-assessable. An adverse ruling by the Commissioner in relation to 51AD and 16D could compromise project viability and may require the project to be fundamentally restructured. Because Commonwealth taxation is a threshold issue for a PFP, WWG Guidelines require a binding tax ruling from the preferred bidder as a condition precedent to any contract.

NSW recognises the Commonwealth's need to prevent abuse of the income tax system. While originally introduced to combat tax avoidance, these tax provisions introduce unnecessary complexity into the structuring of arrangements for privately financed infrastructure. They are outdated and do not recognise the sophisticated approaches to allocating risk between the public and private sectors in the context of public service provision.

The 1999 Ralph Review of Business Taxation[11] recommended the abolition of Section 51AD and the replacement of Division 16D in order to remove the impediments that these pose to private investment in public infrastructure. In response, the Commonwealth Government released "*Exposure Draft – New Business Tax System (Tax Preferred Entities – Asset Financing) Bill 2003*" in June 2003. However, States and Territories and private industry expressed concerns about this exposure draft because, among other things, it effectively widened the scope of application of 51AD and 16D.

In response to these concerns, the Commonwealth has revisited the issue. On 13 Sept 2005, the Federal Assistant Treasurer issued a press statement announcing that a new (as yet undefined) version of Division 250 would proceed. This announcement is welcome. Legislative simplicity, small deal carve-outs, removal of the catastrophic impacts of sec 51 AD, and further stakeholder consultation are all good points for the private sector and NSW. However, any endorsement should be conditional on an examination of the actual Bill.

3.3 Monitoring of Private Investment in Public Infrastructure

This section outlines the various mechanisms and disclosure requirements which facilitate monitoring of PFPs.

3.3.1 Project Management Structures

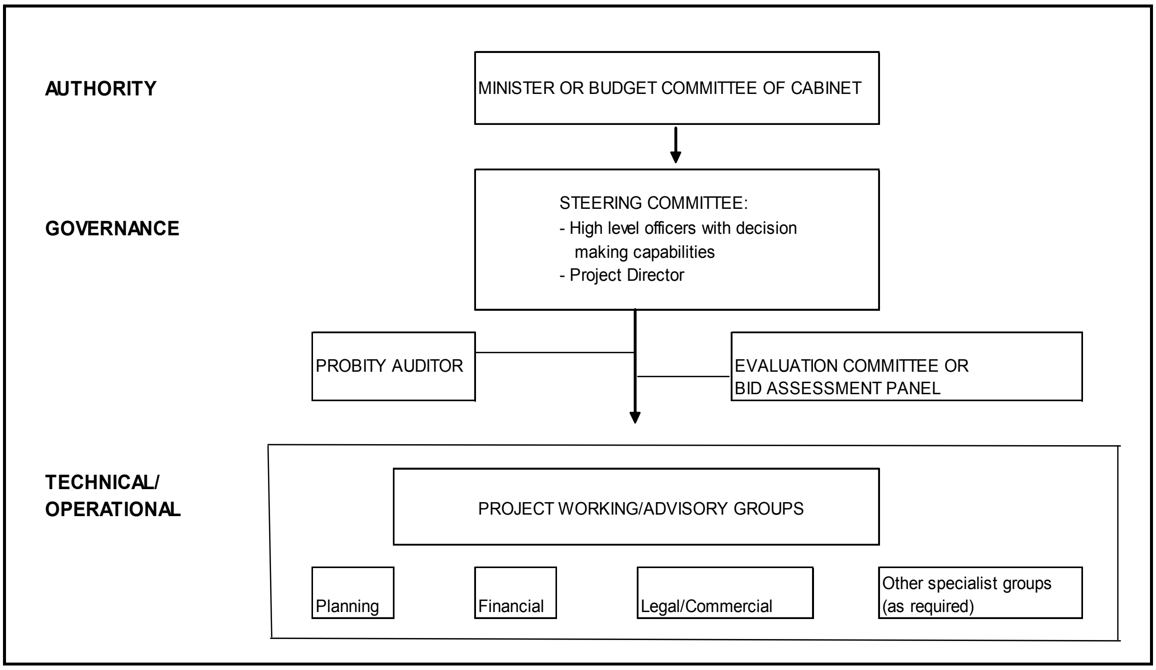
PFPs are complex transactions that require a team-based management approach to ensure that all necessary skills are available. The Government's objective is to bring together significant skill and experience to enhance the success of the project. This requires the Government to utilise internal human resources to fill specialist roles and engage private sector consultants, such as legal, financial, and technical consultants.

Treasury and the service agency, in consultation with other agencies as required, normally agree on a project management structure to oversee the procurement process. The various committees or working groups within the project management structure work together for the period that it takes to transact the project, which will often exceed one year.

A well-established project management structure helps ensure that the procurement process is transparent and that probity requirements are met. Decisions of the project management group(s) or steering committee are documented at each stage of the process. Figure 2 shows an illustrative project management structure for a typical PFP.

[11] More details on the Ralph Review are available on the following website: http://www.rbt.treasury.gov.au/.

Figure 2: Illustrative Project Management Structure



At the highest policy-making level, Government approval is required at various stages of the project – eg, the call for Expressions of Interest and Request for Detailed Proposals, short-listing and selection of preferred bidder, and negotiating parameters for developing the contract documentation. The Government may also approve the project management structure and key parameters defining the project.

At the project level, a steering committee is normally established by the service agency. The committee guides the development of the project and deals with strategic project issues. If more than one agency is involved in project service delivery, one agency is normally designated as the lead agency which convenes the steering committee, and other agencies are represented on the committee. The composition of the steering committee is be determined by the service delivery agency in consultation with central agencies (typically the Treasury, The Cabinet Office and/or Premier's Department).

After financial close, the service agency will normally have its own internal project or contract management structure, and will take responsibility for overseeing project implementation and monitoring the project over the course of the contract. Whilst Treasury officers and consultants can be called upon if problems arise at this stage, in general Treasury's participation in the project ceases at financial close.

3.3.2 Post Implementation Reviews

The WWG Guidelines require that post implementation reviews (PIRs) be undertaken on all private sector infrastructure projects. PIRs are a valuable opportunity for the Government to review processes and procedures. Refinements made to the policy and processes, as a consequence of PIR findings, seek to further enhance the outcomes and benefits of private sector infrastructure projects.

PIRs are undertaken by the project sponsoring agency, and should preferably be initiated about twelve months after the project has become operational. The agency, in consultation with Treasury, decides on the scope of the PIR, which will vary depending on the project.

Generally a PIR will consider project formulation, project objectives, brief appropriateness, design performance, approvals process, project delivery, risk exposure/risk sharing, delivery time, quality, budget performance, project management/procedures, functional competence of infrastructure including networking and interfacing, project operations including service delivery and financing, industrial relations management, community relations, and industry development.

Importantly, the PIR is only one of the periodic reviews of service delivery performance that are undertaken throughout the life of the contracts.

Currently two projects are undergoing PIRs:
- New Schools Phase 1 and
- Eastern Creek Alternative Waste Treatment Facility.

These projects were selected for post implementation review because they were among the earliest to be completed under the WWG Guidelines. Since PIRs are intended to review processes leading to completion of the procurement, it would be premature to select for post implementation review those projects that are still undergoing construction.

The Audit Office has also recently proposed to undertake a performance review of the New Schools Phase 1 project. The terms of reference for this performance review will be complementary with the PIR but will avoid overlap.

3.3.3 Disclosures

Rationale for Disclosures

Government direct expenditure must be approved by Parliament through the approval of Appropriation Bills.

Social infrastructure PFPs that are funded directly out of a public service agency's budget allocation is subject to all disclosures required in connection with Government appropriations. However, some economic infrastructure PFPs such as toll roads entail commitments by Government to allow a private sector company to levy a user charge on public infrastructure. In such cases the Government seeks to maximise public disclosure subject to commercial-in-confidence considerations. For this reason, there are certain disclosure requirements that apply to PFPs.

Statutory Basis and Mechanisms for Disclosure

The requirements to release information contained in a Government contract with the private sector are contained in various Government policies and statutory Acts including:

- *The Working With Government Guidelines for Privately Financed Projects;*

- *Ministerial Memorandum 2000-11;* and
- *Freedom of Information Act 1989.*

The *WWG Guidelines* and *Ministerial Memorandum 2000-11* specify the types of information that must be publicly disclosed and this includes:

- What assets are to be transferred from the government to the private sector;
- The price to be paid by the public and the basis for future changes in the price;
- Provisions for renegotiation;
- Risk sharing in the construction and operational phases; and
- Significant guarantees or undertakings.

All these policies/Acts are broadly consistent in that they exempt the disclosure of specific information including:

1. commercial in confidence material, such as, the private sector's cost structure or profit margins;
2. matters relating to intellectual property/trade secrets; and
3. matters that would put the contractor at a commercial disadvantage with its competitors.

Contract Summaries

For both social and economic infrastructure PFPs, the raw Public Sector Comparator is disclosed in the contract summaries.

WWG Guidelines require that a contract summary must be made available to the Auditor General within 30 days of the contract becoming effective (that is, after all conditions precedent to the contract have been satisfied). The reason that a contract summary is provided is that it includes all non-confidential information in an easily accessible form that interested stakeholders may wish to see.

The Auditor General certifies that the contract summary is an adequate reflection of terms and conditions of the contracts. Within 90 days of receipt by the Auditor General, the audited contract summary will be tabled in Parliament by the responsible Minister. After tabling, the availability of the contract summary is advertised in the Public Notices.

Considerable experience with PFP contract summaries has been gained since WWG was issued in November 2001. Based on experience to date, the Auditor-General has proposed to the Premier an approach to the preparation of Contract Summaries of PFPs that are to be tabled in Parliament, including a standard template and procedures for audit and tabling of the documents.

Commercial-in-Confidence Matters

Consistent with statutory requirements, WWG (page 27) explicitly exempts certain commercial-in-confidence information from inclusion in contract summaries (see the three exempt items listed in the section on ‘Statutory Basis and Mechanisms for Disclosure’).

Any payments made by the Government to private parties cannot be treated as "commercial-in-confidence", and are required to be disclosed. However, matters relating to the internal workings of the private entity are treated as commercial-in-confidence, except where these are required to be reported under the financial and other reporting rules of the Australian Stock Exchange and the Australian Securities Investment Commission.

Some commentators have criticised the Government for not revealing the discount rate applied to PFPs. Due to fundamental differences between Economic and Social Infrastructure PFPs, there may be differences with respect to what may be publicly disclosed. For example, in regard to the discount rate:

- For *Social* Infrastructure, the PSC is discounted by the NSW TCorp borrowing (risk-free) rate, while private sector bids are discounted by the NSW TCorp borrowing (risk-free) rate plus a margin reflecting the systematic risk that is transferred to the private bidder. For social infrastructure PFPs such as the New Schools Phase 1 and the Rail Rolling stock project, the discount rate was disclosed to bidders.
- For *Economic* Infrastructure, the discount rate is the project's weighted average cost of capital (WACC) – i.e., the average cost of debt and equity weighted by the financing shares contributed by each. Hypothetically therefore, if a bidder's WACC or discount rate for an economic infrastructure project were disclosed and other components (i.e., the debt/equity ratio and the cost of debt) were known, it would be possible to deduce the return on equity and the profit margin (a commercial-in-confidence matter) for that project. For this reason, the discount rate may not be disclosed for economic infrastructure projects such as toll roads.

3.3.4 Other Monitoring Mechanisms (not PFP-specific)

Apart from mechanisms and procedures applying specifically to PFPs, it is possible for PFPs to be captured by other systems for monitoring the status of major capital projects.

The Government has recently restructured responsibilities for various aspects of infrastructure decision-making. One of these aspects involves the monitoring by a new Infrastructure Implementation Group based in Premier's Department. This group will be responsible for both monitoring major projects after they have come on stream, and facilitating particular projects where required.

3.3.5 Budgeting and Accounting for PFPs

The final contract terms determine the accounting treatment of PFPs under methods adopted by Heads of Treasuries in 2004. There is no Australian Accounting Standard for PFP arrangements and so Australian Treasuries have, for the time being, adopted a procedure based on the UK Accounting Standard Financial Reporting Standard (FRS) 5[12]. This standard has been adopted in reporting PFPs in the State Budget and annual reports on state finances.

For economic infrastructure PFPs, which are primarily funded by user charges (private revenues), the arrangements will generally be recorded as an off balance sheet transaction.

[12] UK Treasury, UK Accounting Standard FRS 5, "Reporting the Substance of Transactions: Private Finance Initiative and Similar Contracts", 1998.

However, where the asset is to revert to the Government at the end of the concession, a right to receive the asset will be recognised as a progressive annual increase in assets from the commencement of the contract.

Social infrastructure PFPs, which are primarily funded by Government and where usually Government retains the majority of demand risk, will generally constitute a finance lease. As such, they will be deemed to be a borrowing by the State and, once the project is operational, will be recorded as a liability offset by an asset of equivalent value. Depending on the balance of risk allocation, the transaction may sometimes be classified as an operating lease and therefore be off balance sheet, particularly where residual value risk and significant demand risk lies with the private sector.

The accounting treatment of social infrastructure PFPs has the potential to distort agency investment decisions. This may occur where the consequent budget impact creates an incentive to either pursue operating lease arrangements in order to benefit from the deferral of capital-related expenditure, even though the annual lease cost may represent poor value for money; or not pursue finance lease arrangements in order to avoid the budget impact of the capitalised finance payments, even though the finance lease may be good value for money.

In order to address these issues, Government requires that social infrastructure PFPs undergo standard investment appraisals and be approved and funded for conventional procurement before a decision is taken to pursue PFP procurement on value for money grounds.

This “Budget Rule” ensures that the *investment decision* is made on a consistent basis, independent of the way projects are financed. The *procurement decision* is made separately, based on a value for money comparison of conventional and PPP delivery methods. If a project is being pursued as a PFP, it is only after the procurement is completed, and contracts are signed, that capital funding is removed from an agency’s Asset Acquisition Program and funding is provided to meet the annual PFP financing costs.

Although a PFP procurement decision may be justified on value for money grounds, an agency may still confront an annual affordability problem where PFP service fees exceed existing agency budget allocations. This will not be due to PFP financing costs since, as noted above, these costs are funded not out of the agency’s budget, but by Treasury, in exchange for removal of the agency’s capital allocation for the project.

Affordability issues may be due to differences in the way certain operating costs are priced and incurred in the private sector compared to the public sector. In particular:

- The PFP service fee prices asset maintenance on a whole of life basis whereas public sector budgets tend to follow a more “lumpy” profile; and
- The PFP service fee includes an allowance for project risks whereas public sector budgets only provide for these risks when they occur.

There are significant cash flow timing differences between the PFP procurement and conventional procurement models. These are shown diagrammatically in Figures 3(a) and 3(b). The example is based on the construction of a $150 million social infrastructure project having a 3-year construction phase and 30-year operating phase.

Figure 3(a): Cash flow impact of Traditional Procurement

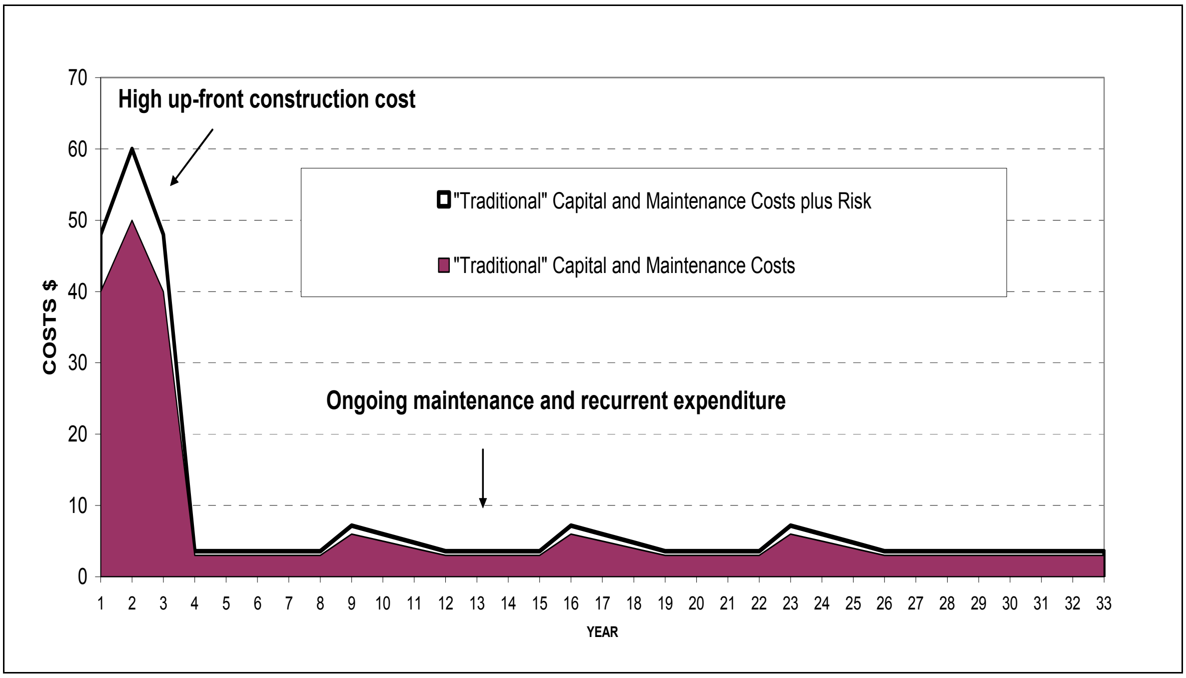
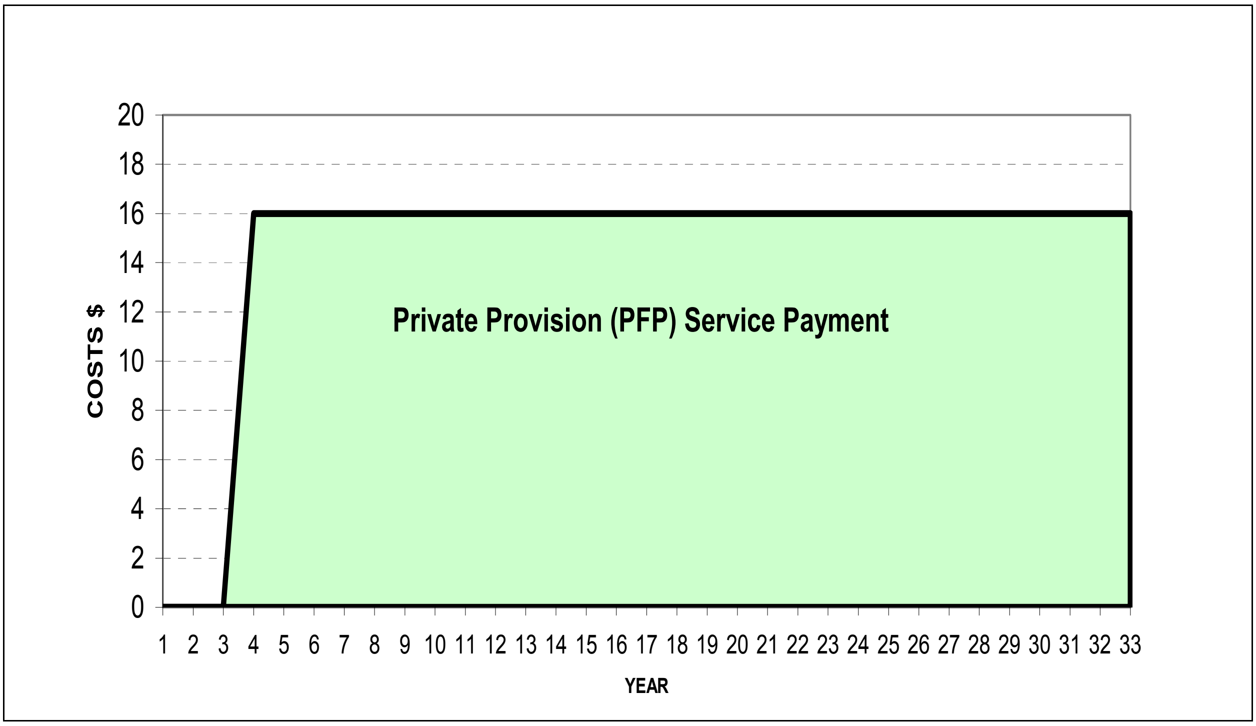


Figure 3(b): Cash flow impact of Privately Financed Project



4 RISK ALLOCATION: FRAMEWORK AND APPLICATION

SUMMARY:

- *Optimal risk allocation is the primary driver of value for money in privately financed projects.*
- *Current guidelines require comprehensive risk identification, assessment, and preparation of risk response strategies. This process generates information which is used, among other things, in the construction of the Public Sector Comparator and the development of risk management plans for the project.*
- *The Government has maintained a considered to risk allocation, while at the same time developing standard commercial principles to provide a more transparent basis for the allocation of risk and the pricing of bids.*

This section responds to Item (c) of the PAC terms of reference, i.e.,

> ***(c) The framework for risk allocation between the public and private sectors and its application, especially how well risk is assessed, allocated and managed.***

It should be emphasised that this section refers primarily to the identification, assessment and management of risk on an *ex ante* basis – i.e., during the procurement stage, before project construction has commenced.

Optimal risk allocation is the primary driver of value for money in PFPs.

Contrary to the belief of some commentators, the Government's aim in PFP procurement is not to maximise risk transferred to the private sector, but rather to optimise the allocation of risks to the public and private sectors according to which party is best able to manage these risks. Being 'best able to manage' risk means that the risk is allocated such that value for money is maximised (or the aggregate cost of managing the risks is minimised) on a whole-of-life basis.

WWG Guidelines require that a full risk analysis be undertaken for each PFP. While it is desirable for Government to adopt a standardised risk management approach to minimise transaction costs, risks must ultimately be considered on a case by case basis due to the length of the contract term and the inevitable complexity of issues involved.

4.1 Standard Commercial Principles relevant to Risk Allocation

As part of the National PPP Forum, the NSW and Victorian treasuries have been working closely to develop a set of standard commercial principles for PFP contracts, in consultation with the private sector. Victoria published their commercial principles document in June 2005, and NSW Treasury is currently preparing a version that will reflect the NSW position on commercial principles. It is anticipated that this document will be available in early 2006.

Standard commercial principles are expected to generate significant efficiencies in PFP procurements, and will lead to shorter procurement timeframes and lower state and private sector bid costs.

The standard commercial principles provide a consistent and efficient risk allocation framework, whilst being flexible enough to allow for the individual needs of each project. Applying these commercial principles to future NSW PFPs will ensure consistency between projects in relation to risk allocation and private and public sector rights and obligations.

The standard commercial principles are intended to apply to social infrastructure and, to a lesser extent, economic infrastructure. NSW has a strong history of economic infrastructure, such as the M2, M4, M5, and M7 toll roads. Since releasing the WWG guidelines, the Government has focused on expanding PFPs in social infrastructure – e.g., hospitals and schools.

There are some significant differences in the allocation of risk for Economic Infrastructure as against Social Infrastructure PFPs:

(a) Market or Demand Risk

In Social Infrastructure PFPs, the project is usually paid for out of tax revenue. There is little or no market risk to the private infrastructure provider, and payment streams to the provider are subject to a long-term contract with the Government. In these projects, cost risks are the key driver of financial outcomes, and the type of service provided has the attributes of a "public good"[13].

In Economic Infrastructure PFPs, most (if not all) revenues tend to be from third parties (e.g., toll road users), and the private infrastructure provider fully bears market risk. In these projects, revenue risks are the key driver of financial outcomes, and the type of service provided has the attributes of a "private good"[14].

(b) Treatment of core versus non-core services

Whilst the Government may derive value for money from private sector provision and the transfer of associated risks of non-core services (such as cleaning services in hospitals), the Government maintains responsibility for providing core services (such as clinical services in hospitals). The standard commercial principles reflect this allocation of services and the corollary potential risk allocation.

It is possible for some projects to exhibit attributes of both social and economic infrastructure (for example, the rail rolling stock project and social housing. See Appendix 4 for more detail on the social housing project). In these cases, risk assessment and allocation is done on a case by case basis.

(c) Translation into Contract Terms

It is essential for a preferred or agreed risk allocation to be appropriately reflected in the contractual agreements between the public and private sectors. Experience to date suggests that for both social and economic infrastructure PFPs, certain contractual terms need to be very

[13] A "public good" is one which possesses two properties: it is non-rival (everyone can benefit from it without diminishing the consumption of others); and non-excludable (it is very difficult or impossible to prevent access to the good), and is therefore impossible to produce for profit. "Pure" public goods possess these properties absolutely, but are rare - examples include national defense and the system of property rights. More often, "public goods" usually refer to "impure" public goods (such as health, education, social welfare, or public order and safety services) or those confined to particular localities.

[14] A "private good" is the opposite of a public good.

clearly specified, otherwise they may have the potential for risks ultimately being allocated in ways not intended by the contracting parties.

Many of these contractual terms tend to be interrelated, and include:

- Default and termination payments and triggers – events of default give rise to cure periods, step-in rights, and termination rights; each of these may affect both the service delivery and payments from the Government.
- Indemnities and required insurances – the contract may require the private party to indemnify the Government for all, or only some, losses incurred by the Government resulting from the design, construction, operation, or maintenance of the facilities.
- Dispute resolution – it is desirable for the contract to be very specific about the mechanism for dispute resolution, and under what circumstances this mechanism applies.

4.2 Risk Assessment

The PFP procurement model aims to allocate and manage risk through a number of mechanisms and procedures.

It is essential to comprehensively and systematically identify and document risks for each project. WWG identifies a number of recommended steps to be undertaken to ensure appropriate risk management. These include risk response planning and document planning (eg, preparation of a risk management plan).

It is now standard practice for PFPs to conduct risk workshops involving key stakeholders (including consultants and specialists in the area) in developing the PSC, as well as in subsequent stages of procurement prior to financial close. These workshops identify major risks likely to befall the project; how much they are likely to cost; and the probability of their occurrence.

The output of this detailed risk identification/assessment process is eventually used in constructing the risk adjustments to the PSC (see section 3.1.2 of this submission), and in drafting key provisions of the project contract.

WWG provides an indicative list of the types of risks that may arise in a project. While this list is not comprehensive, it can serve as a useful guide to agencies in identifying the scope, value and likelihood of certain risks eventuating in the context of the particular project.

4.3 Risk Allocation

It is important to have some degree of certainty or predictability regarding key contractual terms because in the absence of a common set of "rules" understood by both public and private parties, private bids are likely to overprice the risks associated with the project.

The NSW Government has been working to develop a set of standard commercial principles which will embody, to the extent possible, some standardisation of risk allocation. This will provide the market with a common reference point and a more transparent basis for allocating risk and the pricing of bids.

Where it is not possible to place a value on a given risk or to allocate the risk *ex ante*, some of the possible approaches taken in previous contracts include:

- Capping at a fixed amount the maximum for which the Government will be liable should the risk eventuate;
- Providing for an appropriate dispute resolution mechanism to determine how the risk will be shared if it should occur;
- Delimiting or defining very specifically the trigger events that will result in payments by the Government.

The aim is to achieve to the extent possible a consistent basis for the allocation of risk across PFP projects and agencies within NSW; and across jurisdictions. For example, VIC issued in June 2005 a comprehensive set of standard commercial principles developed with input from NSW. NSW is expected to issue its own guidance material on commercial principles by next year. The commercial principles deal with approaches to contractual terms that are likely to be the most salient sources of risk in a PFP.

Table 2 gives an example of risk allocation based on that adopted in the call for Expressions of Interest for the New Schools projects.

Table 2: An Example of Risk Allocation: New Schools Projects

RISK/DESCRIPTION	ALLOCATION		
	Public	Private	Shared
Strategy risk – delivery system, IT, changes in enrolments	✓		
Planning approval costs due to incorrect estimates		✓	
Delayed planning approval			✓
Design development, misinterpretation, provision for future development		✓	
Design requirement changes, changes for legislative or regulatory reasons associated with the public agency	✓		
Construction and Commissioning – incorrect time or cost estimates; site conditions, safety; poor project management; changes in construction methods		✓	
Construction and Commissioning – land availability	✓		
Operations and Maintenance – incorrect time or cost estimates, vandalism and security, insurance, general regulatory or legislative changes		✓	
Operations and Maintenance - specific regulatory or legislative changes			✓
Energy price variations due to volume used	✓		
Energy volume decline due to improvements			✓
Cost of meeting performance standards		✓	
Advances in technology resulting in changes in specification	✓		
Obsolescence		✓	
Residual asset value risk – handover condition		✓	
Taxation and GST		✓	
Inflation			✓

Once a preferred risk allocation is determined, the Government must ensure that this preferred risk allocation between public and private sectors is actually reflected in the terms of the contract. The relevant contractual terms may include key performance indicators and related arrangements to incentivise the private sector to deliver the required quantity and quality of services.

4.4 A Considered Approach

Across projects, the Government has so far adopted a considered "learn-as-you-go" approach to the allocation of risk. Improving knowledge of risks in the context of various projects ultimately leads to a more efficient risk allocation between the public and private sectors in future projects.

Some examples of the evolving approach of the Government to PFP risks are provided below.

- **New Schools Phase 1:** (See Appendix 2 for more details on this project)

  Previously, Government policy was to transfer to the private sector all interest rate risk after financial close. However, this position has changed (see Box 1) because it was determined that it could actually be cheaper in the long run for the Government to bear some of the interest rate risk itself, in conjunction with its management of the overall State debt.

  As a result, the Government is now willing to consider a number of options for sharing of interest rate risk in PFPs. Initially applied in the New Schools 1 project, this more flexible approach to interest rate risk is now being applied in other social infrastructure PFPs.

- **Newcastle Mater Hospital:** (See appendix 3 for more details on this project)

  WWG Guidelines draw a clear distinction between core and non-core services, but is not prescriptive about risk allocation or risk management strategies for each category.

  In the Newcastle Mater Hospital Project, the Government has negotiated a Labour Services Agreement and an Interim Agreement. The Mater arrangements illustrate the potential for different industrial relations approaches to core and non-core services.

  The Labour Services Agreement provides that all non-managerial staff will remain NSW Health employees, and governs the terms on which selected employees will be placed under the management of the private consortium and its subcontractors.

  The Interim Agreement provides for management services prior to commencement of services under the PFP contract, and covers only "soft services" such as catering, cleaning, materials management, helpdesk and general services. The Interim Agreement provides for transition (i.e., spreading out and staging) activities so as to minimise change impacts, with new work practices established prior to the new facilities coming on line.

Box 1:

INTEREST RATE RISK

The NSW Government's previous policy on managing interest rate risk in PPP's required the transfer of all interest rate risk to the private sector after financial close for the term of the concession. In social infrastructure PPP's, private sector proponents have hedged this risk by establishing long-term fixed-rate nominal or long-term CPI-linked debt financing structures. This approach to the allocation of interest rate risk has been justified primarily on the basis that it lends certainty to the State's service payments.

The NSW Government has recently reviewed this policy taking into account the following factors.

- First, the State currently accepts and manages variability in interest rate exposure in its long-term debt portfolios.
- Second, full transfer of interest rate risk in PPP projects may not optimise value for money. This latter point recognises:
    - Full transfer of interest rate risk locks the private sector into long-term funding and discourages them from accessing other markets which may be capable of delivering a more efficient structure,
    - Hedging costs typically rise in proportion to the term of the funding, and
    - Research suggests that long-term nominal interest rates contain a term premium that is not present in shorter term rates. At the current time, this "term premium" is estimated to be in the order of 0.15%pa to 0.25%pa.

The NSW Government has therefore decided to broaden the interest rate risk sharing arrangement applying to social infrastructure PPP's so that the private sector may access a wider range of debt markets.

Under the new approach, the State will continue to bear interest rate risk up to financial close, and the private sector will continue to bear interest rate risk during the construction phase but the State is now prepared to accept interest rate risk during the operational phase. Proponents can now raise funds on a fixed, floating or CPI-linked basis and pass any volatility in those rates back to Government through an adjustment to the periodic service payments.

To ensure a fair and valid comparison of different financing options, the evaluation process converts all proposals to a fixed rate using assumptions as to future floating interest rates and CPI.

5 KNOWLEDGE-SHARING ACROSS AND BETWEEN AGENCIES

SUMMARY:

- *The main conduits for knowledge sharing on PFPs are the Treasury, specialist technical advisers, and inter-jurisdictional forums or working groups.*
- *The exchange of knowledge on PFPs between agencies is encouraged and facilitated. However there may be limited opportunities for exchange between agencies during the course of project development, particularly in regard to project details that are commercial in confidence. There remain a number of mechanisms for exchange of information about PFP procurement that is publicly available– e.g., Treasury guidance material; contract standardisation/commercial principles; contract summaries.*

This section responds to Item (d) of the terms of reference, i.e.,

(d) The extent of opportunities to share knowledge across and between agencies.

Treasury serves as a central repository of information regarding PFPs in New South Wales in regard to:

- technical aspects such as the Public Sector Comparator and risk assessment;
- contract documentation,
- setting up of the procurement framework and strategy (eg, project management structures).

Treasury has used its access to this information to develop a common approach between agencies, and to transfer knowledge between projects as well as between agencies, in regard to PFP procurement.

Transfer of knowledge and capability between agencies may also occur through key advisory groups (eg, specialist legal, financial, commercial advisers), who work with many agencies in the course of procurement of various projects.

Externally, there is an inter-jurisdictional forum (the National PPP Forum) consisting of Ministers who are responsible for PFPs/PPPs in their respective jurisdictions. The Forum is supported by a working party of senior officers. The Forum and the working party regularly exchange information and ideas on policy and implementation of PFPs/PPPs across jurisdictions. NSW and other States sometimes assist each other by informally providing advice on specific projects. This exchange across jurisdictions allows further opportunity to develop standard approaches.

There are many benefits to information exchange regarding PFPs:

- Successive improvement in technical expertise (in terms of build up of data bases, documentation, procedures and project management structures) reduces the cost of developing subsequent projects.
  - For example, the procurement time frame for the second New Schools PFP is on target to be completed within nine months compared with the first New Schools PFP which took around 16 months to complete (from EOI approval to contract award). As a result, transaction costs for both the government and bidders will be substantially reduced.
- Due diligence procedures applied to PFPs (eg, risk identification and allocation, probity and disclosure requirements) represent ‘best practice’, and the scope of application of lessons learnt can be expanded to apply to traditional capital procurement as well.
  - For example, in early 2004 the Government approved major reforms in procurement policy. As a part of those new policies, Treasury adopted some new internal monitoring procedures to be applied to capital procurement generally. Some of these monitoring procedures were developed on the basis of Treasury’s experience with PFPs.

6 MANAGEMENT OF INTELLECTUAL PROPERTY

SUMMARY:

- *IP issues in the context of PFPs have arisen mainly in relation to unsolicited proposals.*
- *For agencies to appropriately manage IP matters, it is essential for them to clearly identify IP aspects of project proposals and key project phases that are open to market testing.*
- *Where a proposal is market tested, Government makes every effort to avoid compromising IP, but must rely heavily on the proponent to supply the relevant IP information.*
- *To date, Treasury is not aware of any IP issues that have arisen in PFP procurement. Such matters are typically noted to be confidential in contracts and hence not released publicly.*

This section responds to Item (e) of the terms of reference, i.e.,

> ***(e) The extent to which agencies are managing Intellectual Property issues.***

Private parties have increasingly been claiming IP rights, particularly when they submit unsolicited proposals. The Government's IP Guidelines for unsolicited private sector proposals submitted under WWG are available on the website: http://www.treasury.nsw.gov.au/wwg/intellectual.htm

The Government's policy on IP in the context of PFPs can be summarised as follows:

- It is considered important for service agencies to clearly identify IP aspects of proposals to ensure IP protection. An agency is expected to manage IP issues during all discussions and develop competitive bidding processes which protect the private sector's IP rights where direct negotiations are not used (i.e. in a majority of cases).
- It is also essential for service agencies to identify key phases of a project open to market testing to ensure the Government achieves value for money without compromising IP rights.
- Unsolicited proposals will generally be market tested to ensure the Government achieves value for money. Direct negotiations on unsolicited proposals will only be undertaken if market-tested.
- Where a proposal is to be market tested, the NSW Government makes every effort to avoid compromising the IP and confidentiality rights of the proponents when preparing a Request for Tender.
- However, in order to achieve this outcome, the NSW Government relies heavily on the proponent to clearly indicate all intellectual property and confidentiality rights. Existing guidelines on IP therefore require unsolicited proposals to include an inventory of significant IP, owner and registration details and other relevant information.

WWG provides that if an unsolicited proposal has significant intellectual property that is of significant benefit to the public interest, the Government may bypass the competitive tendering process and allow direct negotiations. If the Government approves direct negotiation, a public statement will be issued outlining the reasons for this approach. (See section 3.1.3 for further details on the treatment of unsolicited proposals.)

While Treasury is not in a position to assess the extent to which agencies are managing IP issues generally, Treasury is not aware that any IP issues have arisen in PFP procurements in which Treasury has participated and where confidential information has been recognised.

7 CONCLUSION

Privately financed projects are only one of many possible procurement models. While the Government does not see PFPs accounting for the bulk of public sector investment in the foreseeable future, experience to date has established that PFPs are a viable and efficient alternative to traditional procurement, provided that VFM principles are followed. The use of the Public Sector Comparator and the rigorous identification, assessment, valuation and management of project risks effectively constitute 'best practice' and instils greater discipline in the procurement process.

It is timely to revisit the WWG Guidelines and update some of its provisions, based on the considerable knowledge gained about PFPs since 2001. Notwithstanding the need for this update, however, the undeniable conclusion from the experience of the past decade or so is that PFPs have achieved a number of desirable outcomes, most notably:

- on-time and on (or below) budget delivery of major new assets, while at the same time -
- in the case of economic infrastructure, achieving full transfer of market risk to the private sector; and
- introducing incentives or mechanisms to achieve project outcomes (eg, better quality of service) that may not be achievable under traditional procurement, particularly for social infrastructure.

The issue of who bears the cost of the infrastructure in a PFP procurement depends on whether the project is social infrastructure or economic infrastructure.

For high-cost high-value economic infrastructure projects, there is often no financially viable alternative to a 'user pays' regime. Such projects are not affordable in a timely manner if carried entirely on the General Government sector's balance sheet. It should be noted that a decision whether or not to use PFP procurement for economic infrastructure is in part a decision about striking a balance between the interests of infrastructure users and the interests of the entire community.

In the case of social infrastructure, the choice between PFP procurement and traditional procurement is more about service quality and timeliness, as the entire community tends to bear the cost of such projects (i.e., they are funded by tax revenues).

For either social or economic infrastructure, the discipline imposed by PFP procurement helps ensure that the Government obtains value for money. For this reason, it is essential for the Government to continue to conduct its PFP procurements under a set of transparent rules that are clearly understood by both public and private sector participants in the process. At the same time, it is also important to maintain a considered approach to the allocation of risks in such projects so that the rules can adjust to changing market circumstances and attitudes to risk.

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Determination of Appropriate Discount Rates for the Evaluation of Private Financing Proposals (Paper prepared jointly by the Commonwealth, States and Territories), 7 June 2002.

Marton Marosszeky, "Institutionalising Alliances in Construction Projects", Paper prepared for the University of New South Wales, 2002.

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APPENDIX 1: PAC Inquiry Terms of Reference

On 4 May 2005, the Committee resolved to conduct an inquiry and report on private sector investment into public infrastructure, considering the following matters:

(a) New South Wales, Australian and international legislative and policy frameworks and practices regarding private sector investment in public infrastructure;

(b) Government models for evaluating and monitoring private investment in public infrastructure;

(c) The framework for risk allocation between the public and private sectors and its application, especially how well risk is assessed, allocated and managed;

(d) The extent of opportunities to share knowledge across and between agencies;

(e) The extent to which agencies are managing Intellectual Property issues; and

(f) Any other relevant matters.

APPENDIX 2: EDUCATION

Submission to the Public Accounts Committee

Inquiry into Public Private Partnerships

October 2005

NEW SOUTH WALES DEPARTMENT OF EDUCATION AND TRAINING

Contents

1. Background

In 2001, the Department of Education and Training (DET), in conjunction with NSW Treasury, embarked on a feasibility study to assess the value of contracting school construction and ongoing maintenance using a public private partnership (PPP) methodology.

In assessing the project's feasibility, the PPP steering committee examined the UK experience of public private partnerships and prepared a public sector comparator (PSC). The PSC is used to assess the potential savings derived from using a PPP methodology against the usual method of procurement. It calculates the cost of delivering the specified PPP project were it to be financed, owned and implemented by the public sector

The feasibility study, project design and contract negotiations were also informed by the NSW Government publication *Working with Government, Guidelines for Privately Financed Projects, 2001.*

The tender process from calls for expressions of interest to best and final offer negotiations was conducted from October 2001 to December 2002. In December 2002, the NSW Government signed a 30-year contract with Axiom Education Pty Ltd, a consortium consisting of financiers ABN AMRO, builders Hansen Yuncken and St Hillers and facilities managers Spotless Services Ltd. Financial close was achieved in March 2003.

The first NSW schools commissioned under a PPP have been operational since January 2004.

2. The Project – PPP1

PPP1 is valued at roundly $133 million NPV (Net Present Value) with a capital component of $90 million.

The contract requires Axiom to finance, design, construct and provide certain operational services for a 30-year period for nine new schools in urban growth areas across NSW. The services include furniture and porterage, a help desk facility, grounds maintenance, cleaning, waste disposal, security services, disaster (business continuity) management and fire and safety program management.

The schools consist of six primaries, two high schools and one special school. The first tranche of four schools (three primaries and a special school) reached completion in January 2004. The final five (three primaries and two high schools) opened in January 2005. Brochures for each of the nine schools are appended to this submission.

DET also accepted Axiom's tender offer to build and operate long-day-care centres on eight of the school sites. These centres have been opening progressively from late 2004.

The objectives of PPP1 were to:

- Construct nine new schools
- Open four by 2004 and five by 2005
- Create a positive learning environment
- Achieve value for money against the PSC
- Ensure the project is consistent with the public interest
- Satisfy DET's technical requirements and performance standards
- Maintain performance over the life of the contract
- Minimise the environmental impact
- Incorporate safety into the design
- Uphold government construction policies

3. Post-Implementation Reviews

The conduct of PPP1 was informed by the *Working with Government: Guidelines for Privately Financed Projects, 2001*. The project has been subject to a number of independent reviews and audits as follows:

- A report by the project's probity auditors Deloitte Touche Tohmatsu confirmed that the contract process was fair and equitable and adhered to due probity (*Probity Report – New Schools Privately Financed Project, 2002*).
- Deloitte Touche Tohmatsu confirmed the rigour of the calculation of the PSC. (*Letter 2002 – Review of PSC*).
- The NSW Audit Office confirmed that the Contract Summary as tabled in parliament complied with the Working with Government Guidelines. (*Report of Factual Findings in Connection with the New Schools Privately Financed Project Summary of Contracts, 2003*).

Additionally,

- A post-implementation review (PIR) of PPP1 is currently underway. The review has included interviews with key people involved in the project from DET, Treasury, the Department of Commerce, independent advisors and stakeholder groups. The review is expected to be completed by early 2006.
- The NSW Audit Office is currently conducting a performance audit of PPP1. The audit will seek to determine the potential for schools PPPs to deliver better value for money than traditional public sector delivery models. It will examine the work leading up to the award of the contract, the experience of the contract, the experience of similar work delivered through traditional public sector delivery, and the work leading up to the second schools PPP contract.

4. Assessment of Outcomes by DET

Based on the experience of the first 18 months of school operation, in the opinion of DET, PPP1 has proven to offer the following advantages:

Accelerated construction program

- The PPP methodology enabled the schools to be built approximately two years earlier than would have been possible using traditional public sector funding.

- The contractor’s efficiencies reduced the construction time by approximately three months compared with traditional public sector procurement without any diminution in the quality of the final product.

Quality improvement

- The contract ensures that the design, construction and operations phases are the responsibility of a single entity (Axiom). This encourages improved construction quality and maintenance responsiveness.
- School facilities are built and maintained in accordance with DET’s standards for the full contract period.

- The contract contains a non-performance penalty framework. This device ensures prompt response times and improved quality of work.

Economic savings

- Savings of roundly 7% of the project’s cost were made due to the reduced capital cost of the project, a lessened reliance on the Department of Commerce’s project management services (fees) and a reduction in the 30-year cost of providing operational services to the facilities.
- Construction economies of scale were achieved by being able to ‘bundle’ a group of schools being built concurrently.
- The contract provides for benchmarking of the base rates for labour, utilities and insurance every five years. The State and the contractor are then able to negotiate an increase or decrease in the monthly fee based upon any movement in the base rates in the previous period. This gives the contractor confidence that it will be protected from any rate movement not captured by the CPI and gives the government confidence that it can recover any efficiencies or cost reductions which might result.

User satisfaction

- An important feature of Treasury’s PIR has been gathering feedback from the principals of the PPP schools, the primary and secondary principals’ councils and the NSW Teacher’s Federation. Principals report very strong satisfaction with the facilities and their management. The NSW Teachers Federation has commended the improved outcomes that have been achieved through using the PPP methodology.
- Principals of the nine schools report very strong satisfaction with the quality of the facilities and the responsiveness and efficiency of the service provider. Since the commencement of school operations, penalty deductions have totalled roundly 0.04% of the invoiced costs to date, indicating that any cleaning or maintenance requirements are being met within the strict time and quality specifications of the contract.
- School principals are released from much of the day-to-day management of facilities, allowing them to concentrate on educational and staff management priorities. The contractor’s on-site supervisors provide an ‘instant’ facilities

management contact point for schools. Axiom’s 24-hour helpdesk system supports its facilities management effort.

Innovation

- The PPP process allows DET to reduce its reliance upon third-party contract management service providers and to explore new and innovative contract management methodologies. For example, the output specification devised as part of the PPP contract has been used to inform the creation of a new cleaning contract for DET schools.
- PPPs provide an additional opportunity for the creation of pre-schools/long-day-care centres at the same time as the schools are provided. These facilities, which are operated on a fully commercial basis, are seen as commercially attractive to the PPP contractor and advantageous to the local community.

Based on DET’s experience as outlined above and reviews conducted by independent agencies, PPP1 has fulfilled its initial objectives (ref section 2). Procedures and practices are in place to result in the success of the project over the long term.

In May 2005, the Government approved the commencement of the tender process for a second PPP contract. The PPP2 contract is to finance, design, construct and provide operational services for nine schools in urban growth areas across NSW. The first schools in this project are scheduled to open in 2007. It is anticipated that the final schools will commence operations in 2009.

5. Recommendations for Future Projects

A post-implementation review of the project is being finalised and the findings will be incorporated into future PPPs.

6. Conclusion

DET will continue to monitor the progress of PPP1 and will similarly review and monitor PPP2.

The Department is pleased to report that the use of PPPs in procuring targeted school infrastructure is so far proving to be a success.

APPENDIX 3: HEALTH

NSW HEALTH

SUBMISSION TO

LEGISLATIVE ASSEMBLY

PUBLIC ACCOUNTS COMMITTEE

INQUIRY INTO PUBLIC PRIVATE PARTNERSHIPS

NOVEMBER 2005

Contents

1. Executive Summary

The NSW Government's *Working with Government* Guidelines for Privately Financed Projects provides the framework for improving public service delivery through private sector provision of infrastructure and related non-core services. This framework enables both the sectors to work together in areas of social infrastructure such as health and education.

In its review report on NSW Health "Focusing on Patient Care", the Independent Pricing and Regulatory Tribunal (IPART) recommended that NSW Health should fully explore the use of Privately Financed Projects (PFPs) in funding and delivering Health capital projects.[15]

NSW Health is committed to ensuring that decisions on investment, whether through conventional procurement or PPP, are informed by a sound evidence base and meet the Government's requirements of equity, efficiency and accountability. NSW Health has currently progressed two PPP projects in accordance with the Guidelines. In pursuing these projects, the underlying principles and approaches are:

- PPP is one of a range of procurement routes to delivering Health capital works, infrastructure and related services to the people of NSW. PPP is only a procurement tool – not an end in itself. It will only be used in cases where it offers value for money to the community and NSW Health.

- PPP does not bring new funds into the Health Capital Program. Rather, it converts planned capital expenditure to an annual facility and services fee over the life of the PPP commercial deed.

- A value driven approach is applied to PPPs, supported by a rigorous assessment of value for money and optimum risk allocation.

- Employee protection is built in the Health PPP model through a Labour Services Agreement.

- Ongoing improvements to PPP procurement are being made and are being developed as standard templates and guides.

NSW Health is working closely with NSW Treasury on current PPP projects and continues to research experiences in other jurisdictions in Australia and overseas. It is noted that there have been successes in the delivery of new facilities under the alternative PPP financing and management arrangements developed in the UK[16] and across a number of Australian states[17].

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[15] IPART report on NSW Health Focusing on Patient Care, August 2003 p 79. This report was tabled in NSW Parliament in September 2003.

[16] An overview of PPP developments in the UK is provided in section 2.3 of this submission.

[17] In Victoria, the PPP projects are the Berwick Community Hospital ($100m) and the Royal Women's Hospital Redevelopment ($250m).

With growing demand for infrastructure services including health services, it is essential that public and private sector stakeholders work together to achieve timely and efficient development of public infrastructure.

NSW Health will continue to create an environment which encourages private sector participation in the provision of health infrastructure and to create the level of competition needed to deliver value for money outcomes. In doing so, processes and tools will be further developed in consultation with NSW Treasury to achieve protection of the public interest and an appropriate balance between the interests of stakeholders.

2. Introduction

NSW Health welcomes the opportunity to contribute to the Public Accounts Committee Inquiry into Pubic Private Partnerships (PPPs).

NSW Health is responsible for ensuring that the people of NSW are provided with the best possible health care. To achieve this, an extensive program of capital investment of over $2.5 billion will be implemented over the next five years. PPPs can bring public and private sectors together in long term partnership for mutual benefit. It is considered that PPPs have a role in the delivery of the health investment plan and are complementary to conventional procurement.

This submission brings together information on NSW Health's PPP projects and approach to PPPs that directly relate to the Public Accounts Committee (PAC) Terms of Reference. These are presented in the following sections:

Section 2: A summary of policy framework and practices in Australia and UK.

Section 3: NSW Health approach to PPPs

Section 4: Labour Service Agreement

Section 5: Improving PPP procurement

3. Policy framework and practices

Government policy positions in Australia

In recent years, all Australian Governments have released PPP policies and guidance material of differing level of details. One common objective is to increase private sector confidence in the development of PPPs. The various policies are as follows:

- NSW – Working with Government: Guidelines for Privately Financed Projects, November 2001
- Victoria – Partnerships Victoria 2000 and most recently, detailed guidance material on standard commercial principles released in June 2005.[18]

[18] The Partnerships Victoria policy was independently reviewed in 2004. The Fitzgerald report made a number of recommendations (eg reducing bid costs, streamlining the procurement process and the minimum size of PPP project) which have been supported by the Victorian Government.

- Queensland – Public Private Partnerships Policy: Achieving Value for Money in Public Infrastructure and Service Delivery, September 2001.
- Western Australian – Partnerships for Growth: Policies and Guidelines for Public Private Partnerships, December 2002
- South Australia – Partnerships SA: Private Sector Participation in the Provision of Public Services, September 2002
- Tasmania – Private Sector Participation in Public Infrastructure Provision – Policy Statement and Guiding Principles, July 2000
- Northern Territory – Territory Partnerships: Policy Framework, February 2003
- Australian Capital Territory – Statement of Objective and Principles for the Private Provision of Public Infrastructure, December 2002
- Commonwealth Policy Principles for the use of the Private Financing – June 2002.

Central to the Governments' approach is to use PPPs where they provide better value compared to public sector investment. The PPP policy recognises that public and private sectors have distinctive but complementary roles to play. All PPP models require a fundamental shift of thinking with focus on outcomes rather than inputs.

NSW Policy Framework

In November 2001, the NSW Government released its "Working with Government: Guidelines for Privately Financed Project" policy document (the Guidelines). These Guidelines provide a consistent, efficient, transparent and accountable set of processes and procedures to select, assess and implement PPP projects.

The strategic policy directions are:

- The private sector will be utilised to assist Government in delivering social infrastructure and services but not core services.

- PPP procurement will only proceed where value for money (VFM) is demonstrated compared with conventional public sector delivery and where PPP satisfies a range of public sector requirements.

- The Public Sector Comparator (PSC) includes risk-adjusted and full life cycle costs of public sector delivery of the infrastructure and related services.

- Risk allocation should be structured to deliver appropriate and optimal risk transfer to the private sector or public sectors, which ever is best able to manage the risk.

- Fair and equitable treatment of public employees will be assured where they are managed by a private employer, as part of a PPP.

In accordance with the Guidelines, the drivers of VFM are expected in the following areas:

- Improved risk management – More rigorous risk evaluation and transfer to the private sector of those risks it is best able to manage, including those associated with providing specified services, asset ownership and whole-of-life asset management.

- Ownership and whole-of-life costing – Efficiency is improved because design and construction become fully integrated upfront with operations and asset management. Ongoing service delivery, operational, maintenance and refurbishment costs become the private sector contractor's responsibility for an agreed concession period.

- Innovation – Wider opportunities and incentives for improved solutions both for the facility design and services delivery.

- Asset utilisation – Reducing costs to government, as a sole user, through more efficient design to meet performance specifications and by creating complementary opportunities to generate revenue from use of the asset by other parties.

- Whole-of-government outcomes – These include non-asset and non-price related value-adding outcomes of wider interest to the Government such as socio economic and environmental outcomes.

One of the features of PPPs is that payments to the private sector are deferred until the building and services are fully operational. As a result, the first payment of a unitary charge under the PPP process is likely to occur up to two years later than any costs that would have been incurred under a traditional process and capital costs are effectively amortised over the length of the PPP agreement.

However, it should be noted that deferral of payments under a PPP is not regarded as a benefit as the procurement decision will be primarily on value for money. Under NSW Treasury Guidelines, projects must be funded for conventional delivery before consideration will be given to pursuing a PPP.

PPPs can also act as a value benchmark against which public sector service providers and conventional contracting options can be compared. This will help foster improvements in public delivery of facilities and services.

The policy framework also requires public disclosure of a contract summary. At the conclusion of the project procurement, a contract summary will be submitted to the Auditor General for audit, followed by tabling in Parliament and making available to the public. This disclosure regime is an important part of the accountability framework.

The PPP model has substantially evolved from the Private Finance Initiative in the UK which has matured and been used as an effective procurement of social infrastructure over the last decade. An overview of the UK experience is discussed in the following section.

The UK experience

In the UK, approximately 90% of health care is delivered through the publicly funded National Health Service (NHS). In England, the NHS is centrally directed by the Department of Health (DoH). There are 28 Strategic Health Authorities who are responsible for the performance and strategic development of services. These authorities report to the DoH. Local health services are the responsibilities of over 300 Primary Care Trusts (PCTs) who provide all primary care services through general practices and commission secondary care services from Hospital Trusts.

In the UK, the two major PPP models are the Private Finance Initiative (PFI) and the Local Improvement Finance Trust (LIFT). PFI was developed in the early 1990s to deliver infrastructures across all sectors, including health and education. Since its inception in 1992, UK PFI policy has been subject to scrutiny by the National Audit Office. The Blair Government further refined and developed PPP from 1997. PFI is now at an advanced stage with several of the major hospitals procured now operational.

The Private Finance Initiative in the UK

With 451 projects now operational (including 34 hospitals), the UK government has taken stock of the performance of the PFI program to-date against construction performance, delivery against budgets, bidder selection, procurement times and operational performance.

Research conducted by the UK Government and others such as the National Audit Office, confirms the largely positive impact of PFI to date and highlights areas where there is scope for further improvements. Of 61 PFI projects, the key findings were:[19]

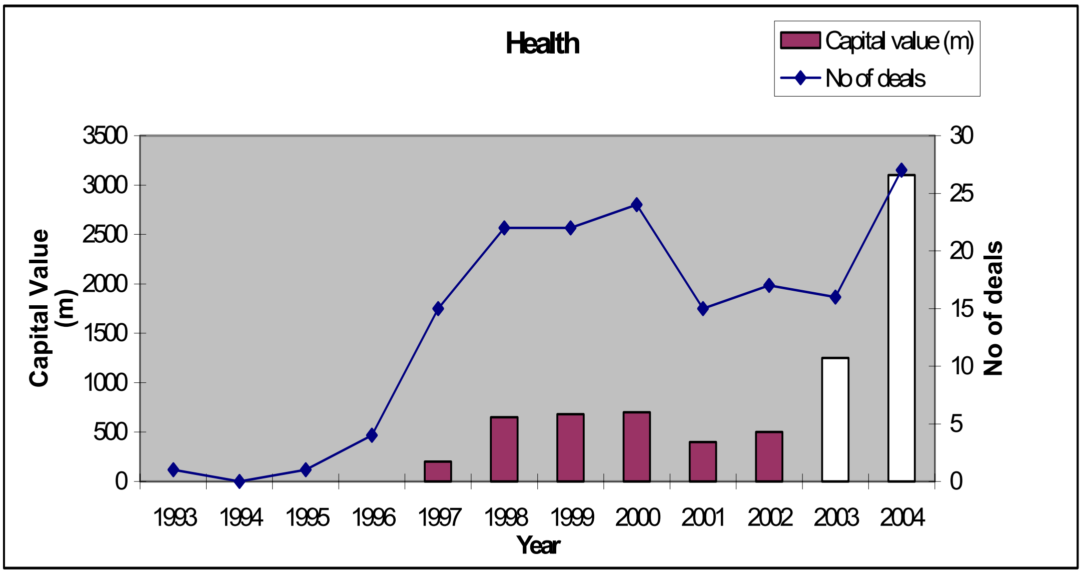
- 89% of projects were delivered on time or early;
- all PFI projects in the HM Treasury sample were delivered within public sector comparators;
- 77% of public sector managers stated that their project was meeting their initial expectations;
- there is scope to reduce procurement times.

Two previous independent reports by the National Audit Office into aspects of the PFI programme further support many of these findings, providing evidence of improved construction performance over non-PFI projects and public sector client satisfaction.

Importantly, over the past six years, the UK Government has pursued a strategy for enhancing worker protections and ensuring their fair and reasonable treatment in PFI projects. This appears to be generally accepted in the PFI markets without compromising private sector interests in such deals.

In 2003/04, PFI investment accounts for 11% of total investment. As for health PPPs, there has been a total investment of £3.2 billion with 117 PFI projects signed as at July 2003.

[19] PFI: Meeting the Investment Challenge, UK Treasury, July 2003, p4.



Note: The white columns represent the estimated capital value of projects that are expected to reach financial close in 2003/04.
Source: HM Treasury, UK – PFI: Meeting the Investment Challenge – Further Background Information.

The Department of Health are expecting to see both the number of capital value of deals signed rise significantly over the next two to three years. The projected number of deals for health is 55, amounting to a total capital value of £6.5 billion by the end of 2005.

The Local Improvement Finance Trust (LIFT)

NHS Primary Care LIFT was created as a nationally managed procurement program by Partnerships for Health (PfH), a company formed as a joint venture between the Department of Health and Partnerships UK. The key features of this program are:

- LIFT is an investment program to help improve the primary care estate.
- Local LIFTs are set up as PPP with PfH, local Primary Care Trusts (potentially individual practitioners) and the private sector as shareholders.
- Local LIFT will build and refurbish primary care premises which it will own. It will rent accommodation to GPs on a lease basis.
- LIFT enables small construction companies to bid/participate in health projects – more competition.
- A standardised procurement approach, including the agreements to be entered in relation to each scheme.
- Creation of a sustainable, predictable flow of transactions for the private sector to permit forward planning of future capacity to bid and implement such schemes.

The Department of Health made start up funding of £195 million available, with the aim of levering in a total of up to £1 billion of private investment between 2000 and 2010. This investment in primary care is unprecedented in the history of the NHS.

As at early 2005, LIFT is still at an early stage. Most LIFT companies are operational but few buildings are open. Most of the developments to date have been well received by local stakeholders.

In its recently released report in May 2005, the UK National Audit Office (NAO) examined whether LIFT will support improved primary and social care services that meet local needs while providing value for money. The NAO concluded that "it looks as if LIFT will work – at national level LIFT is an attractive way of securing improvements in primary and social care. The local LIFT schemes appear to be effective and offer value for money".[20]

Implications

It is generally acknowledged that whilst some of the early projects in the UK had less than ideal outcomes partly due to a lack of adequate preparation and process, the use of PFI has yielded significant benefits for the National Health Services in the UK. Australian jurisdictions including NSW, have the opportunity to leverage the UK experience (e.g. standardised contracts, procurement processes etc) such that the PPP process in NSW can achieve good practice and best value for money.

The UK experience has shown that savings on health projects have been relatively marginal compared to other sectors[21], but there are still savings which can be diverted into frontline patient services.

There is potential application of the LIFT model to NSW in developing joint community partnership. For example, a proposal to build a Health and Specialist Centre on the Singleton Hospital campus is currently under consideration and review. The proposal requires an up front investment in the Singleton Health Management Unit Trust with joint ownership with local practitioners. The Trust will build, own, finance and maintain a Health and Specialist Centre on the Singleton Hospital campus under a lease for 25 years.

4. NSW Health's approach to PPP

Objectives and Principles

The objectives of PPPs in health infrastructure are to:

- deliver improved health services by improved methods of investment in health services;
- release the full potential of health assets and hence provide increased value for money and wider benefits for the community in comparison to the conventional public sector procurement of the services;

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[20] National Audit Office, UK: Department of Health Innovation in the NHS: Local Improvement Finance Trusts, May 2005.

[21] Based on a sample of 29 projects, the UK Treasury Taskforce reported in 2000 that the average percentage estimated saving against the Public Sector Comparator was 17%. Risk transfer valuations accounted for around 60% of the total cost savings forecasts for 17 projects.

- create economic benefits to be shared between all stakeholders (including private sector partners, investors, the community, clients and employees).

The intended outcomes are:

- Enhanced efficiency
- Optimal risk transfer
- "Whole-of-life approach"
- Better facility management
- Earlier or on time project delivery within budget
- Innovation
- Better asset utilisation

PPP requires considered decisions about long term service delivery requirements. The financial commitments entered into for the life of the contract are not only to provide the health facility but also a guaranteed level of ongoing service delivery to pre-agreed performance levels specified by NSW Health. Therefore, PPPs invest in the future because it ensures that assets are maintained properly throughout their life to support the delivery of clinical services and can revert to the public sector at the end of the contractual period in good condition. PPPs achieve disciplines of sound asset management throughout the asset life.

When to use PPPs

The level and mix of services to be delivered under any new NSW Health hospital and investment project is determined during development and approval of Service Procurement Plan (SPP) and Project Definition Plan (PDP).

In deciding whether a particular capital project may be suitable for PPP, NSW Health applies the criteria set out within the Working with Government Guidelines. This specifies the following factors are taken into account:

- What is the scale and complexity of the project?
- Is there scope for innovation in design?
- What is the nature and scale in relation to the provision of non core services?
- What is the value for the transaction?
- What is the market appetite?
- How a PPP assessed against public interest criteria (effectiveness, impact on key stakeholders, accountability and transparency, public access and equity, consumer rights, security and privacy)?

Overview of PPP projects in Health

NSW Health has currently progressed two Privately Financed Projects, one at the Newcastle Mater Hospital Redevelopment and the other at Long Bay Forensic Hospital. The key lessons from these two pathfinder projects are:

- The project is viewed from a whole of life cycle perspective and hence considerably more effort is given to analysing and planning for the facility operation.
- The financial regime builds in forecast cyclical maintenance whereas in conventional projects, this is treated on a periodic basis through the respective Area Health Service or from the Health Asset Acquisition Program.
- There is enhanced capacity to build in design and operational innovation provided this achieves value over the life cycle.

The involvement of private sector in taking on performance risk provides incentives for project performance. This includes project completion on time and on budget, and to take into account the whole of life costs of health infrastructure in design, construction and delivery of support services.

In addition, NSW Health has pursued other partnership arrangements to better utilise the potential of Health assets. They include the Newcastle Community Health Centre and co-location of Aged Care facility at Croydon Community Health Centre and Sutherland Hospital.

Newcastle Mater Hospital Redevelopment PPP Project

This partnership project includes:

- $34 million for the fast tracking of a purpose built 96-bed adult mental health unit to include an additional 10 acute adult mental health beds.
- $80 million for the redevelopment of the 176-bed Mater Hospital.
- Refurbishment and enhancement of the existing radiotherapy facilities.[22]
- The provision of maintenance, cleaning, catering, security, utilities and materials management services to the Mater campus for the contract term of 25 years.

The Newcastle Mater Hospital site will be a highly specialised health site and a centre of excellence for the provision of mental health and cancer services within the Hunter and New England network. The overhaul of health services will also offer 96 acute mental health beds - 10 more than currently offered at James Fletcher Hospital.

Under the PPP model, this vital health project will be completed under a single contract and at better value than if developed under a standard public sector project.

Further to an Expressions of Interest and Request for Detailed Proposals during 2004 and 2005, the successful proponent, Novacare, was announced in July 2005. Under the new contract Novacare Consortium will build the facility over a period of approximately 3 years and operate the non clinical services on behalf of the State Government over the period of 25 years. The facilities will revert to public ownership at the end of that 25 year period.

[22] In addition, NSW Health will fund $18 million for the almost doubling of radiotherapy services on the hospital site with an additional two radiotherapy bunkers and linear accelerators and new brachytherapy facilities.

This contract has been developed by health experts and commercial advisers in the finest of detail to ensure the best result for staff, patients and the health dollar.

Clinical and non clinical staff will continue to be employed within the public sector by the Mater or Hunter New England Area Health Service, however non clinical support staff will be under the day to day management of the new facility management provided by Novacare.

The Mater PPP includes a “Labour Services Agreement” (LSA) which gives effect to the principles agreed between the Premier and the Health Services Union in March 2004.

Financial Close for this project is expected in the second half of 2005.

Overall, the advantages of this public private partnership are:

- Allowing the provision of the new mental health and radiotherapy facilities and services sooner than would have been the case with the staging approach under conventional Government funding and procurement.
- The three project elements of acute hospital, radiotherapy expansion and mental health hospital are completed under a single integrated contract, allowing better coordination of the design and construction of the components and the ability to better manage impact on staff, patients and the community.
- The provision of services in one integrated facility is more cost effective and will facilitate better patient care.
- The new facility will deliver services more efficiently as well as providing better working conditions for staff.
- Assurance of quality construction – the contractors will work to Government Guidelines.

Public interest benefits from the Mater project being delivered as a PPP are:

- The provision of better health facilities on the Mater site will improve care of people with mental illness and cancer, and increase the Area’s ability to attract health professionals to the Hunter Area.
- This will be a highly specialised health site and a centre of excellence for the provision of mental health and cancer services within the Hunter New England Area Health Service.

Long Bay Forensic and Prison Hospitals

This project is to build a new 135-bed Forensic Hospital to be located adjacent to the Long Bay Correctional Complex. The capital cost is $65 million. All clinical services will be provided by Justice Health. This project enables the separation of forensic patients from sick inmates in a maximum security correctional complex with an internal environment being that of a modern psychiatric hospital.

Expressions of Interest were called early in 2004 and three short listed proponents submitted detailed proposals in late December 2004.

Negotiations are currently proceeding with a Preferred Proponent. Subject to the outcomes of final evaluation and negotiations, it is anticipated that the contract will be awarded by the end of 2005.

The project is being undertaken jointly with the new Prison Hospital for the Department of Corrective Services with NSW Health as lead agency in the procurement as a PPP project. The bundling of two projects will reduce disruption to current prison and forensic health services at Long Bay with new services to be brought on line more quickly. The integrated project also enables improved construction scheduling and savings while achieving the design philosophies specified by the two Government agencies.

Croydon Community Health Centre

The Croydon Community Health Centre co-locates a wide variety of services through an innovative project between the former Central Sydney Area Health Service, Catholic Health Care Services and Bovis Lend Lease. The cost of this purpose built health facility is $24 million as part of the total $80 million project.

Construction commenced in February 2003 and the facility became operational in November 2004. Community services are administered by the Area Health Service and the nursing home facilities by Catholic Health Care Services. As the first purpose-built community health centre in NSW, it is a modern one-stop integrated provider of a broad range of community health services including child, adolescent and family health. In addition, Catholic Health Care Services operate a 127-bed residential care community service on the site which includes a low care hostel and high care nursing home and specialist dementia care for aged people.

This project represents one of the largest public/not-for-profit/private partnerships in NSW between the Area Health Service, Catholic Health Care Services and Bovis Lend Lease. This project was approved as a “Barter Project” with the Area Health Service achieving substantial revenue from surplus areas of the site and handover of a completed purpose designed facility for public services.

Newcastle Community Health Centre

The Newcastle Community Health Centre is part of the Government’s detailed $236 million Newcastle Strategy for the redevelopment and modernisation of the Hunter’s medical infrastructure. The Centre will provide a comprehensive range of community-based health services to people in Newcastle, including outpatient services from one convenient location.

This project provides alternative provision of health facilities other than conventional capital funding. The Hunter New England Area Health Service (HNEAHS) will lease part (around 43%) of a new building to be designed, constructed, financed and owned by the private sector. The lease term is 20 years plus 5 + 5 renewal options.

The successful contractor, Austcorp/Abigroup has purchased the Hunter Street site from Hunter New England Health to build a five-storey 11,100 square meter facility. The Building will be a mixed medical and commercial office building to accommodate the Health Centre's needs. Hunter New England Health will be a long-term tenant, occupying almost half of the building.

The contract was awarded and signed in early September 2005 with the commissioning of the centre expected in early 2007. This is an example of partnership arrangements to deliver a project more quickly than if traditional funding methods had been used.

Co-location of Aged Care facility at Sutherland Hospital

This project includes a 112-bed residential aged care facility on the Sutherland Hospital site with 10 transitional care beds to assist in relieving access block within the hospital.

In a Call for Proposals in April 2004. the private sector was invited to submit proposals for the demolition of existing structures, and the design, construction, management and operation of a Residential Aged Care Facility on the Development Site at Sutherland Hospital, Sydney, and to obtain all necessary approvals. Contract documentation is being finalised with the preferred private sector proponent.

This is one example of freeing up an unused parcel of land to provide a community benefit, and assist front-line health services. Subject to conclusion of contract negotiations, construction is anticipated to commence in late 2005 and is scheduled to be completed in 2007.

This partnership arrangement will offer the following benefits:

- The transitional beds will improve the hospital's capacity to free up beds and hence address accommodation for emergency patients.
- Rental revenue over the lease period will supplement Area funds for frontline services.
- On completion of the lease, the aged facility will be transferred to the Area Health Service.

Hospital carparks

Major hospital car parks have been procured under the Working with Government Guidelines and have included projects at the Randwick Hospitals (Prince of Wales, Royal Hospital for Women and Sydney Children's Hospital), St George and Nepean Hospitals.

In principle, car parking projects should be self funding and a variety of financing and construction options are being considered depending on the circumstances of each project.

The key difference with privately funded car parks is that the revenue stream supporting the investment is from private revenue outside the health budget. They can therefore proceed independently of the financial limits imposed on NSW Health, provided they stand commercially.

This approach will ensure that all health capital budget allocations would be utilised for the delivery of health infrastructure projects.

The expected benefits for car parking model under PPPs are:

- Modern car parks providing benefits to staff, visitors and patients through easier access, better lighting and security.

- Commercial funding allowing:
  - Car parks to be constructed when needed rather than competing with other priorities for scarce health capital funds.
  - Public capital funds can then be devoted to facilities required for core health care services.

5. Labour Service Agreement

The NSW Government is committed to ensuring fair and reasonable treatment for existing public sector employees in PPP projects. That is, value for money delivered by PPPs does not come at the expense of public sector health employees' terms and conditions.

For the Newcastle Mater PPP project, a Labour Service Agreement (LSA) has been developed to give practical effect to the undertakings made by the NSW Government in relation to the employees of the Area Health Service and the Newcastle Mater Misericordiae Hospital and those engaged at Mental Health at James Fletcher. The LSA will enable the successful private sector proponent (Project Company) to provide maintenance, cleaning, catering and other specified non-clinical services to the Newcastle Mater Hospital on a long term basis utilising the services of employees of the Area Health Service and the Mater Hospital.

The LSA is a major innovation developed by NSW Health to address employee protections within a PPP project. The LSA developed for the Mater is also being applied to the Forensic Hospital PPP project.

The current Project Deed incorporates the LSA over the term of contract. The LSA provides for private sector management of public sector staff. Similar approaches have been used in other states and overseas, eg the Transfer of Undertakings (Protection of Employment) Regulations in the UK which guarantee transferees "at no less favourable" terms and conditions at the time they transfer from one employer to another. The private sector has accepted the concept without major concern.

It is important that the principles behind LSA, workforce protection and adequate flexibility to deliver high quality non core support services, are achieved. NSW Health is committed to monitoring the implementation of the LSA during operational phase and working with the private proponent to ensure staff protection is achieved.

6. Improving PPP procurement

There are efforts to achieve a consistent approach across jurisdictions through the Partnership National Forum and collaboration between state treasuries. Nevertheless, some differences in terms of policy guidelines are likely to exist, reflecting local circumstances.

Key challenges and success factors for PPPs are:

- A full assessment of the marketability of the project be made before a PPP procurement is undertaken.
- Ensure a competitive market is available.
- Ensuring an effective procurement process to:
  - keep transaction costs in both public and private sectors to a minimum eg use standard documents but with flexibility to reflect the characteristics of individual projects.
  - reduce procurement times.
- Managing effective partnership relationship between the public and private sectors that recognise their mutual responsibilities.

Developing and strengthening the level of healthy competition among the private sector is key to harnessing the efficiency and VFM. Strategies for encouraging private sector bids are:

- A more certain market in PPPs.
- Smoother flow of PPP projects to build the confidence that the market is sustainable.
- Reduced transaction costs for PPP projects for both the private and public sector, including the use of standard documents and templates.

The NSW Treasury's Private Projects Branch has been a core part of the Health PPP procurement process, providing valuable advice and directions on current health PPP projects. NSW Health finds this has worked well and values the partnership approach that has developed. In this role, Treasury has acted as a conduit for sharing knowledge and experience from other agencies and sectors and has assisted NSW Health in progressing its two PPP projects. Treasury is also a core member of the PPP project team.

NSW Health considers improving PPP procurement is part of a broader program to achieve efficient and effective asset procurement. Key linkages to other improvement initiatives are:

- Improvements to conventional procurement have also been informed by PPP learning. In particular, revisions to the Project Definition Plan component of NSW Health's Process of Facility Planning are being made to improve costing for facility management and support services during the project life. Regardless of the procurement method, an initial estimate of the raw Public Sector Comparator will be required which will assist in assessing recurrent cost impacts and identifying areas for efficiency improvement.

- Improvements to Health's Conventional Asset Procurement model will deliver system wide practice improvement. The new Asset Procurement model for new projects will deliver:
  - Higher quality health facilities more quickly and completely.

  - The re-engineered roles of the key participants will result in greater efficiency and accountability.
  - The Health and Construction Business Improvement initiatives will deliver better value for money.

This will present additional challenge for the private sector to compete on value with conventional procurement.

NSW Health is continuing to work closely with NSW Treasury on:

- Document standardisation to reduce bid costs and improve consistency for future projects.

- Development of a PPP library of reference documents, guidance materials and cost benchmarking database as means to provide support and share good practice within NSW Health and potentially with other agencies.

- Capacity building through knowledge transfer from advisers to in-house support teams and to retain expert staff with a thorough understanding of PPP projects.

NSW Health will continue to refine the support services specifications to ensure they are an appropriate standard for each PPP project as well as reflecting the market responses on the Newcastle Mater Hospital Redevelopment and Long Bay Forensic Hospital PPP Projects.

REFERENCES

HM Treasury, UK, Value for Money Assessment Guidance, August 2004

HM Treasury, UK, PFI: Meeting the Investment Challenge, July 2003

HM Treasury Taskforce, Report commissioned by the Taskforce - Value for Money Drivers in the Private Finance Initiative, January 2000

IPART, Report on NSW Health: Focusing on Patient Health, August 2003

NSW Government, Working with Government Guidelines – Privately Financed Project, November 2001

National Audit Office, UK, Report on Local Improvement Finance Trusts, May 2005

Research was conducted on the following websites in regard to PPP developments:

http://www.hm-treasury.gov.uk

http://www.nao.gov.uk

http://www.treasury.nsw.gov.au

http://www.treasury.vic.gov.au

http://www.dh.gov.uk

APPENDIX 4: HOUSING

NSW DEPARTMENT OF HOUSING

Submission to the Public Accounts Committee Inquiry into Public Private Partnerships

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INTRODUCTION

The Department of Housing has recently initiated the first social housing Privately Financed Project (PFP) in NSW. The Bonnyrigg Living Communities Project involves the integrated renewal of the Bonnyrigg public housing estate, located in the Fairfield LGA.

The Department believes PFPs may have the potential to provide benefits in the delivery of housing services. They may also provide the potential for innovation in service delivery and the diversification of housing management. PFPs represent one of a range of procurement methods for delivery of social housing services.

This submission is limited to issues involved in the development of PFPs in the social housing sector. The Department recognises that PFPs are part of a broader spectrum of Public Private Partnerships (PPPs).

The Bonnyrigg Living Communities Project was announced in December 2004. The Bonnyrigg PFP involves a number of distinct elements: the integrated renewal of a highly disadvantaged public housing estate; the redevelopment of up to 800 public housing properties to provide new private and social housing stock and the provision of facilities management and tenancy management services over a 30 year period.

Over the last 20 years, most states in Australia have been renewing their public housing estates, almost all involving private sector financing including through development joint ventures. Social housing management has also been diversified over the last two decades, in particular through not-for-profit community and cooperative housing arrangements. Despite this, direct private sector involvement has been minimal. The Bonnyrigg Living Communities Project is the first public private partnership in Australia to combine both renewal/redevelopment and housing management service delivery. There is therefore significant interest in the project from other public housing authorities, social housing and social services advocate groups and the private sector.

PFP procurement is not appropriate to every project and the Department expects to utilise the full range of procurement approaches as appropriate to the particular circumstances of future projects. The Bonnyrigg Living Communities Project is a pathfinder project, with a significant investment in developing models and approaches that may prove applicable to other projects.

Bonnyrigg Living Communities Project

The Bonnyrigg Living Communities Project involves the integrated renewal of the Bonnyrigg public housing estate, which is home to some 3,300 people. The Estate forms part of the Fairfield Local Government Area, covers an area of 81 hectares and contains 833 social housing dwellings and approximately 100 privately owned properties.

A large part of the estate was constructed on a Radburn subdivision layout, which detracts from amenity by, among other things, making it more difficult for residents to survey the street, allowing offenders to avoid police detection or apprehension and increasing feelings of personal insecurity. The estate also contains significant areas of poor-quality and under-utilised open space.

The project is designed to achieve comprehensive sustainable and integrated social and physical renewal of the estate, particularly by:

- Improving services and providing residents with better opportunities
- Supporting the local community to build its strengths, skills and overall capacity
- Renewing both housing and public areas and achieving better integration of social and private housing within the community.

Projects of this kind need to be designed to achieve renewal and re-imaging of areas to attract a wider social mix and realise underlying capital value whilst respecting and maintaining those aspects of community life that are critical to the existing community. Engaging and involving the community in the project will be fundamental to the success of the project because it ensures that issues of importance to the community are recognised and respected. It further ensures existing residents derive benefit from the project and thereby maintain their support for it. The need to involve the community in this intensive way poses issues that are not common in other social or economic infrastructure projects.

The successful proponent will be required to provide comprehensive and integrated services in the following areas:

- Management and integration services
- Communication and consultation services
- Community renewal services
- Tenancy management services, including rehousing
- Facilities management
- Development planning
- Development
- Construction of private housing for sale
- Construction and refurbishment of social housing.

RESPONSE TO THE TERMS OF REFERENCE

The following provides a response to each of the Terms of Reference for the Inquiry:

Legislative and policy frameworks and practices regarding private sector investment in public infrastructures

The Commonwealth State Housing Agreement between the NSW and Commonwealth governments has as one of its objectives the promotion of private sector investment in social housing. The agreement recognises that private investment has the potential to expand the provision of social housing, promote innovation and to otherwise achieve social housing goals.

In conceptualising and procuring the Bonnyrigg Living Communities Project, the Department's primary reference has been to the *"Working with Government: Guidelines for Privately Financed Projects"* produced by the NSW Government. These guidelines apply to all NSW Government agencies and provide a comprehensive and detailed framework for the development, approval and implementation of PFP projects. The Department also conducted detailed discussions with NSW Treasury, the Roads and Traffic Authority and the Department of Education and Training about their experiences with PFP projects. These discussions drew on lessons learned among NSW Government agencies that may be applicable in the social housing sector.

In addition, in developing the project, the Department examined the approaches being used in a range of relevant interstate and international social housing projects involving partnerships with the private sector. Within Australia, there is a wide range of projects, most centring on the renewal and redevelopment of public housing estates or other areas of concentrated public housing. All the interstate projects involve various forms of joint venture with the private sector or project management by the private sector, rather than PFPs.

The Department has taken a particular interest in the approaches to renewal and with private sector involvement in two projects: the *Westwood* project in Adelaide and the *Kensington* project in Melbourne. These projects have provided the Department with important lessons in relation to renewal programs in public housing communities, the elements of a successful partnership with the private sector and insight into appropriate commercial and contractual arrangements.

Internationally, the most relevant experience is in the United Kingdom. There is a developing market in the UK for private investment in social housing and a growing number of projects developed under the Private Finance Initiative. The Department has comprehensively reviewed all the Private Finance Initiative projects currently under development or being implemented and is aware of the approaches being taken in a range of other locations and jurisdictions. Each of the UK Private Finance Initiative projects includes facilities management and tenancy management within the project scopes.

The information on good practice obtained from this review process has been extremely valuable in developing the approach to PFPs in the social housing field and in structuring the Bonnyrigg Living Communities Project.

Government models for evaluating and monitoring private investment in public infrastructure

In developing the Bonnyrigg Living Communities Project, the Department has observed the processes set out in the *Working with Government Guidelines*. The project is now in phase 3, involving the development of Detailed Proposals by a shortlist of proponents. The phases (and timeframes) for the project are outlined below, giving emphasis to the evaluation and monitoring processes in each phase.

Phase 1: Project Definition

This phase involves the essential strategic planning components, including project planning, the initial project development and early consultation with key stakeholders.

For the Bonnyrigg Living Communities Project, the Department undertook a comprehensive planning process to identify potential project sites. This initial pre-feasibility process involved a range of public housing estates in the Sydney Metropolitan area. Detailed feasibility studies were then carried out in six of the studied areas from the pre-feasibility phase. The Bonnyrigg Estate was subsequently identified as the preferred project site.

More detailed planning and project definition work was then conducted and a preliminary Public Sector Comparator (PSC) was developed. A comprehensive proposal was then developed and submitted for approval.

Approval to proceed was granted in early December 2004 and the project was announced.

Phase 2: Expressions of Interest and short listing

The call for Expressions of Interest was released in January 2005 and submissions closed at the end of March 2005. A detailed evaluation of the Expressions of Interest was conducted by a Project Evaluation Committee established specifically for the project and a shortlist of three proponents was identified.

The shortlist was approved in July 2005 and announced in August 2005.

Phase 3: Detailed Proposals and Assessment

A Request for Detailed Proposals was developed and provided to the short listed proponents in September 2005.

Proposals are to be received by the end of February 2006. These proposals will then undergo a detailed assessment against a set of Evaluation Criteria set out in the Request for Detailed Proposals.

The evaluation process for the Request for Detailed Proposals will involve the assessment of the proponents' proposals for each of the major service areas included in the PFP contract. The Evaluation Committee is chaired by the Department of Housing and includes a Treasury representative and a range of experts in critical project areas, including property development, financing, social housing management and community renewal.

Phase 4: Negotiations, Contract Signing and Financial Close

This phase involves the negotiation process to be conducted with the successful proponent, reaching agreement on the contract and the signing of contractual documentation, leading ultimately to the financial close. This process is anticipated to conclude in September 2006. Final approval is required prior to the conclusion of the contract and its execution.

Phase 5: Implementation

Following the execution of the contract, the project will move into the implementation phase. Responsibility for most aspects of the project will transfer to the Project Company (comprising the successful proponent) on the transition date, approximately six months after financial close.

Phase 6: Monitoring and Evaluation

As this submission illustrates, there are a range of Government approval points in the process and a range of evaluation and monitoring processes. NSW Treasury is active at all points in the process. The Project Steering Committee provides overall direction for the project and is chaired by the Director-General of the Department of Housing and includes representatives of NSW Treasury, the Premier's Department and The Cabinet Office.

During project implementation, a contract management team within the Department of Housing will undertake detailed monitoring of project performance against key performance indicators as set out in the contract. Performance failures against key performance indicators will result in the abatement of monthly service payments to the Project Company.

The overall success of the project will also be subject to a number of additional monitoring and evaluation processes. The Department has internal requirements for project reporting and monitoring of major projects. The *Working with Government Guidelines* also requires a review of all aspects of the project development and implementation process within 12 months of start up. In addition, the Department is working with the University of Western Sydney to develop an evaluation framework for the project, in particular focusing on the on-the-ground processes for engaging and working with the Bonnyrigg community. These evaluation processes aim to improve practice as the project proceeds.

The Department believes these monitoring and evaluation arrangements are comprehensive in their scope and effective. The *Working with Government Guidelines* is a comprehensive guide to agencies in the development and implementation of projects.

The framework for risk allocation between the public and private sectors and its application

The risk allocation documented in the Request for Detailed Proposals is intended to maximise value for money by allocating risk to the party best placed to effectively manage it. The aim is not to maximise risk transfer to the private sector.

The documented risk allocation is consistent with (but not identical to) that outlined in the *Working with Government Guidelines*. Adjustments were made to reflect the nature of the social housing system and the unique circumstances of this project.

The PSC includes an allocation for risk and will reflect a full analysis and pricing of risk. This risk adjusted Project Steering Committee is the benchmark against which proposals will be judged to determine their value for money.

The extent of opportunities to share knowledge across and between the agencies

There have been significant opportunities to learn from the experience of other Government agencies in the development of the Department's approach to PFPs and the Bonnyrigg Living Communities Project. The Department had access to the significant body of experience present in the Roads and Traffic Authority, the Department of Education and Training and NSW Treasury in the development of the project. The framing of the land development component of the project was greatly assisted by Landcom's experience in working with the private sector. The cumulative experience of NSW Treasury as a central repository of knowledge about PFPs was a critical source of assistance in shaping the project.

In addition, a range of expert advisers from the private sector (legal, property development, private financing and technical) have assisted the development of the project. These advisers, drawn from firms specialising in PFPs, bring a wealth of experience from their involvement with other PFPs in NSW, elsewhere in Australia and also internationally.

Such international and interstate project experience has also helped in shaping the project, not only in the development of the commercial and contractual framework, but also in developing an approach to renewal in disadvantaged areas and the engagement of affected communities.

While these information sharing processes are largely informal in nature, they have worked well from the Department's point of view.

The extent to which agencies are managing intellectual property issues

The Department is following NSW Government and NSW Treasury guidelines for the management intellectual property (IP). Broadly, these work as follows:

- If the private sector believe they have developed IP in their proposals, they are required to clearly identify that IP and outline the case for it to be considered as IP
- Consistent with the NSW Government and NSW Treasury guidelines, if the Department agrees that IP is involved, the Department will take necessary steps to ensure the appropriate protection. This necessarily involves a case-by-case consideration.

CONCLUSION

The Department welcomes the opportunity to make this submission. We emphasise that PFPs are one of a range of options and that the best procurement approach needs to be shaped for each particular project based on its particular circumstances.

The Bonnyrigg Living Communities Project is a pathfinder project, to build private sector interest and capability, to test value for money and to develop a set of good practice models and approaches.

Broadly we believe the *Working with Government Guidelines* provides a comprehensive and effective guide to the development and implementation of such projects. The Department believes the monitoring and evaluation requirements set out in the guidelines are comprehensive and effective and that the associated Government approval processes work well. The arrangements for sharing knowledge and information across Government agencies, while largely informal, have worked well to date for the Department in relation to the Bonnyrigg Living Communities Project.

APPENDIX 5: PORTS

Legislative Assembly Public Accounts Committee Inquiry into Public-Private Partnerships (PPPs)

Sydney Ports Corporation

Sydney Ports Corporation (SPC), in fulfilling its charter as a State Owned Corporation, is responsible for the effective management of the commercial ports of Sydney Harbour and Port Botany.

Sydney Harbour's port facilities handle a wide range of vessels including dry bulk, general cargo and motor vehicles. Facilities are located at East Darling Harbour, Glebe Island, White Bay and private berths at Gore Cove and Blackwattle Bay.

Port Botany caters for container trade and the bulk liquids industry, both of which require specialised berth facilities and supporting land based infrastructure. Port Botany also has a privately operated oil berth facility at Kurnell.

In its Sydney Harbour facilities, SPC owns the land including the wharves, the pavement and the buildings that cater for a diverse range of trades. Specialised equipment and additional structures are provided by private sector operators. At Port Botany, SPC is responsible for providing the strategic substructure and the tenants are responsible for the significant investment in superstructure and operating equipment.

As the landlord and port operator, SPC specifies the commercial activity to take place on state-owned land (eg container/break bulk/bulk liquid loading and unloading); manages a competitive lease tender process; collects revenue for pilotage and wharfage services; and monitors certain activities related to environmental and safety requirements.

To provide the port services that are critical to NSW's import/export logistics chain, SPC enters into strategic relationships with private sector providers. Many of these relationships with the private sector involve significant investment by both the private sector and SPC (Government).

SPC follows a landlord model of PPP relationships in which it owns and develops the substructure (eg wharf structures, channels, breakwaters and land platforms) while private stevedoring companies own and develop the superstructure (eg container cranes, heavy duty pavements, pipelines, buildings and chemical storage tanks).

Review of alternative PPP strategies for the proposed Port Botany expansion

As part of SPC's consideration of alternative delivery strategies for the proposed Port Botany expansion, SPC engaged consultants PricewaterhouseCoopers to assess the merits of alternative funding models.

The consultants examined in detail the existing landlord model, as described above; the Build, Own, Operate and Transfer (BOOT) model; the Design, Build and Maintain (DBM) model; and the Design, Build, Finance and Maintain (DBFM) model.

While the detail of the report is commercial-in-confidence to the Ports Corporation, PricewaterhouseCoopers concluded that the landlord model was the preferred option because it allowed full capture of private sector benefits through efficiencies and risk transfer relating to the operation of the container terminal handling facilities.

PricewaterhouseCoopers also found that the landlord model represented the best structural option for achieving an optimal balance between private sector involvement in the terminal superstructure, while permitting SPC to take responsibility for proceeding with the development of the substructure, particularly in circumstances where the project characteristics do not suggest that terminal substructure has the factors which typically enable a privately financed project to deliver best value.

SPC favours an extension of the existing Port Botany landlord model as ownership of the substructure would assist SPC in its port management role and enable a consistent business model across all stevedoring terminals in its jurisdiction.

The landlord model promotes competition as it leaves the way open for a third stevedore to potentially enter the market on similar terms to the existing stakeholders. Public ownership of the substructure would also prevent an individual stevedore from gaining an entrenched advantage over competitors, through ownership of the substructure. Someone else building the substructure would result in a loss of revenue to SPC (with consequent effect on tax and dividends to its owners) and a possible need to provide concessions and/or financially support the developer.

Newcastle Port Corporation

Newcastle Port Corporation pursued the development of the Multi-Purpose Terminal at the former BHP steelworks site in Newcastle by following the "Working with Government Guidelines on Privately Financed Projects".

The Guidelines provided a strong framework for managing the project. The tender process benefited from the support of the project Steering Committee, made up of a number of stakeholder government departments and corporations. The expert advice of the NSW Treasury Private Projects Branch was particularly beneficial.

The MPT is an economic infrastructure project, which could be more correctly described as a tendered "business opportunity" for the private sector rather than a traditional PFP. Private sector participants in the project demonstrated a lack of understanding of Privately Financed Project models, generally expecting the landlord model to be adopted for port development. This was reflected in private sector resistance to the proposed risk allocation, despite extensive work being undertaken by government to establish a comprehensive and appropriate risk allocation regime.