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Council of Social Service of New South Wales

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Committee Manager
Public Accounts Committee
Parliament House
Macquarie Street
SYDNEY NSW 2000

Dear Madam/Sir

Please find enclosed a submission prepared by the Council of Social Service of NSW (NCOSS) in relation to the Public Accounts Committee Inquiry into Public Private Partnerships.

I hope that the Committee will favourably consider our comments.

If further information is required please contact Dev Mukherjee, Senior Policy Officer, on 9211 2599 ext 130, or by email dev@ncoss.org.au.

Yours sincerely

Gary Moore
Director

Submission to the Legislative Assembly Public Accounts Committee Inquiry into Public Private Partnerships

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Council of Social Service of NSW (NCOSS)
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1. ABOUT NCOSS

The Council of Social Service of NSW (NCOSS) is the peak body for the social and community services sector in New South Wales. NCOSS works with its members on behalf of disadvantaged people and communities towards achieving social justice in NSW.

NCOSS provides an independent voice on welfare policy issues and social and economic reforms. It is the major coordinator for non-government social and community services in NSW.

2. INTRODUCTION

NCOSS welcomes this inquiry and is pleased to comment and propose improvements to financing of public infrastructure in NSW. NCOSS main concern with PPPs is the effects on disadvantaged people and communities that are not often considered in the PPP process.

NCOSS understands Public Private Partnerships (PPPs) as contractual agreements between a public agency and a for-profit non-government organisation. The types of contractual arrangements include Build-Own-Operate (BOO), Build-Own-Operate-Transfer (BOOT) and Build-Transfer-Operate (BTO). The specialised skills, comparative advantages, and assets of each sector (public and private) are supposed to be shared in delivering public infrastructure or service. In Australia, PPPs are more often used for infrastructure than service provision.

Under most arrangements in Australia, the private sector finances and constructs a public facility in return for the right to operate the facility and obtain revenue from user charges (e.g. a toll on a motorway) or sales (e.g. houses from land development).

Public Private Partnerships (PPPs) have become popular as governments all over the world seek to minimise the financial and political cost of high public debt levels associated with large infrastructure projects. Public infrastructure (hospitals, roads, electricity generators, etc) is usually expensive and governments across the globe have sought ways to generate private sector investment to obtain better value from public expenditure on infrastructure. In Australia, all governments agree on the need to set limits on public borrowing, although this is political decision rather than an economic necessity.

Many proponents of PPPs make generalised claims about their effectiveness in developing infrastructure and delivering services. For example, claims are often made about the benefits associated with risk transfer to the private sector and the benefits of private sector management skills, innovation and efficiencies. These claims need to be assessed carefully as PPPs vary in the degree of private sector involvement and the level of control by the public sector in development.

In this submission, NCOSS recommends that a set of guiding principles be established to ensure social goals are included in the assessment process. Further, the submission highlights the issues relating to assessing private investment in public infrastructure (item b in the terms of reference) and the risk allocation between the public and private sectors some of the issues that should be considered while making decisions on private investment in public infrastructure (item c). Finally, the submission reiterates the widespread concern regarding transparency and accountability in contracting arrangements (item f).

3. GUIDING PRINCIPLES

The following proposed guiding principles seek to ensure that economic and social benefits arise from public private partnerships. These are based on guiding principles adopted as policy by the NCOSS Board in relation to private investment in the development of social housing:

- The provision of certain services, especially those supporting disadvantaged and low-income people, is the joint responsibility of the state, federal and local governments. Some services (e.g. social housing) are not the responsibility of the private sector.

- Certain services are a core function of the state government, especially those which are of critical importance in addressing social disadvantage (e.g. social housing).

- In some instances, there may be a valid role for the private sector in partnering with the state government to increase or improve the infrastructure associated with the provision of these services.

- Public infrastructure should be considered as both an economic asset and a social resource. For example, social housing estates are communities, government schools are local resources.

4. ASSESSING PRIVATE INVESTMENT IN PUBLIC INFRASTRUCTURE

The NCOSS policy on private investment in social housing also provides criteria for assessing whether a particular proposal should be supported (see attachment 1). While the criteria are specific to assessing private investment in social housing, they provide a guide for how other PPPs could be assessed.

When assessing whether to implement a PPP, the NSW Government needs to consider:

- the social impacts of private investment in the development including the constraints the PPP may have on future actions by the Government;
- the cost to the government of developing infrastructure; and
- the cost to the user.

Social impacts of private investment in public infrastructure

Private investment in public infrastructure can have social effects depending on the nature of the investment. Often the 'innovation' associated by some with the private sector bears significant social costs not considered at the time of the PPP contract. Further, contracts between government and the private investor can limit the ability of the government to achieve social outcomes.

The social impacts of private investment in public infrastructure are most stark in the development of social housing. The availability of capital from the private sector may distort investment decisions. For example, there are a considerable number of public housing estates that require redevelopment to address issues such as poor initial design, degraded housing stock, and excessive concentrations of disadvantaged people. To overcome this situation will require a long term redevelopment and investment strategy. To the extent that governments seek access to private capital to do so, priority locations for redevelopment are likely to be selected based on their perceived attractiveness to the private sector (as real estate opportunities). This could result in some needy estates being overlooked if they are not seen to have sufficient appeal to the private sector, particularly rural areas.

Further, the profit for the private investor is most likely to arise from the development and sale of median to high cost housing rather than low cost and social housing. This is likely to change significantly the social mix within a community.

While contracts between the government and private investor may set a proportion of social housing to be included in the development, a private investor is likely to desire a relatively low level in order to maximise profit. The impact here could be to reduce the number of residences set aside for social housing, thus further disadvantaging a high needs group.

Private investment in human services infrastructure needs to ensure a social return to the community that is as explicit as the commercial return to the financial backers.

For a social return to be guaranteed the government must not include in contracts items that limit changes to government policy, particularly when the contracts extend for thirty years or more. The earlier PPPs in Australia and around the world limited the ability of the government to develop competing infrastructure without providing significant compensation to the private financier.

Some motorway contracts prevented governments from developing public transport routes or required compensation to be paid in lieu of lost revenue.

Governments also need to have the ability to respond to new and changing economic, social and environmental concerns as they arise. The nature of PPPs is to limit the capacity of governments to change policy as contracts are for lengthy periods. For example, in the UK, the new healthy school dinners policy is running into difficulty because some private operators of school canteens are unwilling to risk a change of menu and privately financed new schools do not have sufficiently equipped kitchens to prepare fresh food. To ensure that the social and health outcomes are paramount, any new requirements should be seen as part of the risk associated with the investment.

Cost to Government

The most common argument for private investment in public infrastructure is that PPPs reduce public borrowing and hence government expenditure on interest repayments. The money saved can then be spent on services such as schools, hospitals and police. The actual cost to the government depends on the method by which the private investor will recoup their investment and make a profit. This method is usually determined by the nature of the contract (BOO, BOOT, etc).

For example, a motorway financed totally by the private investor will charge tolls to motor vehicles. In this situation the cost to the government is minimal provided the piece of infrastructure is successful in raising a profit and the risk is allocated to the private investor (risk allocation is discussed below).

In a situation where the private investor builds an asset (e.g. a public school) and leases it to the relevant authority, the cost to the government is likely to be high. In these circumstances a PPP will save the government money only when the rent and other fees paid to the private investor are less than the rate of interest at which the government could borrow for the same development. As governments can borrow at a lower rate than private organisations such a scenario is unlikely. In addition, the complex arrangements often involve higher legal, negotiation, and transaction costs making the contract less attractive for the government.

It might be argued that the ability of governments to borrow at a lower rate than the private sector reflects the ability of governments to levy taxes and charges to repay the loan thus lowering risk to the lender. Private sector borrowing has to incorporate the risk involved with individual projects and, it might be argued, public sector borrowing should account for the risk in individual projects. The effect is to make private financing more cost effective than it would otherwise appear. This argument misses the point. Governments invest in public infrastructure for general community benefit whether this is in social housing, rail lines, roads, schools, electricity generators, or hospitals. It is therefore reasonable for taxes to be levied to pay for some of the infrastructure.

Other arguments that suggest PPPs can lower costs to government for infrastructure suggest that the private sector is more innovative than the public sector and that the private sector is better able to manage assets than the public sector. These are no more than assumptions based on the belief that private borrowing provides stricter discipline to managers than governments can achieve. There is no evidence to support these assumptions nor is there evidence to completely reject them. However, there is some evidence to suggest that private firms lower costs through paying lower wages and have worse conditions for employees. This is hardly innovative. More likely is that genuine innovation and asset management rely on the ability and talent of the people involved in the project rather than the private/public divide

Cost to the government is only one factor associated with evaluating PPPs, and although important, should not be the sole determinant of whether a piece of infrastructure is permitted to be privately financed.

Cost to the user

Depending on the nature of the contract the private investor in a PPP may be permitted to levy users to recoup their investment and make a profit. In some circumstances the 'user' will be government (e.g. leased public schools buildings) while in others it will be a member of the public (e.g. motorway tolls). In many circumstances the fee charged is determined by the private investor in a monopoly situation. Further, the government may pass on the cost to consumers by raising user charges.

Where the government passes on the cost, user charges are likely to be increased substantially. For example, the 500 mega litre desalination plant planned for Sydney will raise the cost of water to $1.44 per kilolitre.

The price of water will rise even if there is substantial rain in the catchments and the desalination plant is financed through a 'take or pay' contract. Sydney Water would be obliged to pay a large percentage of the contract price. Sydney Water will be required to pay the operators of the plant even when no freshwater was produced. The exact amount will depend on the contract but is likely to be in the vicinity of $150 million per year. Under these sorts of arrangements the consumers could be paying more for a 'white elephant'.

While Sydney Water may be a monopoly, the public can have some confidence that prices are established by an independent regulator, the Independent Pricing and Regulatory Tribunal (IPART). No such oversight exists with private monopoly services (such as motorways) where prices are established by the operator or under the contract with the government. At no time are prices considered by an independent regulator to assess their fairness. Tolls appear to have increased with no justification except to provide a windfall profit to operators. NCOSS believes that prices for services provided by monopoly operators of public infrastructure should be regulated by IPART.

Costs are not only financial but can affect amenity of a particular area. For example, a development in social housing, even if it does not reduce the amount of social housing may change its nature, for example from free standing houses to units or town houses as these are more cost effective.

4. RISK ALLOCATION BETWEEN THE PUBLIC AND PRIVATE SECTORS

A common argument in favour of private investment in public infrastructure is that there is risk associated with the development of the infrastructure and this is better managed by the private sector.

However, the experience in NSW and elsewhere is that governments ultimately hold the risk. Two early PPP experiments in NSW did not adequately minimise risk to government. Port Macquarie Hospital, initially developed and operated by the private sector, was effectively 'nationalised' by the NSW Government. The Airport Rail Link, which was supposed to be totally privately financed, has cost the NSW Government around $800 million.

Where PPPs are said to have been successful, governments appear to have guaranteed favourable conditions to attract private funding for the construction and/or operation of large-scale infrastructure. The development of competition that may affect the revenue is dependent on compensation to be paid to the private investor (e.g. a rail line competing with a motorway) or the government guarantees income independent of market conditions (take or pay contracts). So risks are generally minimised by ensuring competition is limited, and alternatives are not developed or revenue guaranteed. Without the government bearing significant project risks, private interests are unlikely to invest.

While the private investors appear to convince governments to minimise their risks they are benefiting from windfall profits. Private investors are not accepting risks but are taking the benefits. Clearly a better balance is needed to ensure that the public benefits from the profits, by for example, incorporating community service obligations into the contracts.

5. TRANSPARENCY IN CONTRACTS

A major concern to the NSW public is the secrecy often surrounding PPP arrangements. Too often claims have been made that PPP arrangements are either commercial-in-confidence or privileged. The public loses a lot of confidence in governments when matters are kept unnecessarily secret.

The recent controversy with the Cross-City Tunnel is a good example. The requirement for road closures on alterative routes was in the contract but the cost of not proceeding with those only became widely known when the contract details were finally released. The secrecy surrounding this was unnecessary from the commencement of the project. Such information should be clearly in the public domain as it is fundamental for the public to assess the viability and appropriateness such infrastructure developments.

Application of PPPs to social housing raises particular issues of transparency in decision making. We note that with the Bonnyrigg project only the initial Expression of Interest documentation has been made publicly available. To date stakeholder groups including NCOSS have been unable to access the Government's detailed statement of requirements that has been given to the three short listed consortia. This makes it extremely difficult for NCOSS and others to independently assess whether the results of extensive community consultation are reflected in the tender process, or whether the government's bottom lines are adequate in terms of housing delivery, sound design principles etc. Without such independent assessment there is a loss of public confidence in infrastructure leading to additional community concern.

6. CONCLUSION

NCOSS believes that proposals for private investment in public infrastructure should:

- ensure there is a social return to the investment (e.g. increase in social housing stock);
- PPPs should be a last resort in areas that are core government activities, especially those that address social disadvantage.
- demonstrate a financial benefit to the Government; and
- ensure prices to users are fair by having them regulated by IPART and not significantly higher than if the infrastructure was owned by the government and financed from user fees.

Further, the contracts between the government and private investor need to ensure that risks associated with the project are fairly placed with the investor. This includes the ability of the government to develop competing infrastructure or change its policies without restriction or unfair compensation. Finally, greater transparency is needed in developing proposals and in the contracts between the government and private investor.

Attachment 1

Assessment Standards for PPPs in Social Housing

Proposals for the provision of social housing that involve the private sector will be assessed by NCOSS using the following criteria:

1. Increase in social housing stock

- The proposal should result in a substantial increase in *social* housing stock.

- In any proposal that involves the redevelopment of an existing housing estate, the preferred tenure outcome is a ratio of private to social housing stock that favours current and future social housing tenants.

- If the proposal does not result in additional social housing stock on the particular site, then all revenue gained should be dedicated to the increase of social housing stock in an area with good infrastructure and access to services. Revenue raised should not be regarded as general funds under the Housing Assistance Program.

2. Impact Assessments and Probity

- The process must be transparent and include a public interest evaluation. As stated in the governments PFP guidelines, this includes an 'evaluation of the likely impact of the project on public interest including effectiveness, impact on key stakeholders, accountability and transparency, public access and equity, consumer rights, security and privacy (p 55)." The evaluation should involve all stakeholders and be a publicly available document.

- Comprehensive social and environmental impact assessment should be conducted in relation to all proposals.

- 'Probity is an important issue for government as custodian of the community's assets' (ibid. pg 49). The process of tendering and decision making in relation to PPPs should adhere to transparent probity standards and procedures.

3. Tenant Rights

- Consultations should be held with all potentially affected tenants *prior* to the development of any proposals.

- The amenity of adequate open space and privacy should be considered in any proposed development to avoid the social problems that can arise from inappropriate development.

- Tenants should not be required to relocate unless it is absolutely unavoidable. Where it is unavoidable, the Department of Housing should ensure that there is minimal disruption to the tenants' lifestyle and existing networks. Those tenants with strong links in the local community should be given priority relocation in that area.

- The full costs of relocation should be met by the Department.

- The rights of existing tenants should be respected at all times.

- All existing tenants must be guaranteed quality housing in the renewed estate (if they wish) and given a clear timeframe for this to occur.

4. Sector Consultation

- When a project is first considered or proposed by the Department, consultations should be held with all relevant peaks including ShelterNSW, the Tenants Union of NSW, the NSW Federation of Housing Associations and NCOSS.

5. Financial Benefit

- There should a demonstrated financial benefit to the Department of Housing.