

**Submission
No 16**

PROCUREMENT OF GOVERNMENT INFRASTRUCTURE PROJECTS

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Australian Government

Department of Infrastructure and Regional Development

Secretary

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Mr Alister Henskens SC MP
Chair
Legislative Assembly Committee on Transport and Infrastructure
Parliament of New South Wales
6 Macquarie Street
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Dear Chair

Inquiry into the procurement of government infrastructure projects

Thank you for the opportunity to provide a submission to the Committee's inquiry into the procurement of government infrastructure projects (the Inquiry). The Australian Government's Department of Infrastructure and Regional Development (the Department), which plays a leading role in land transport infrastructure as a funding, assessment and monitoring body, has portfolio oversight of a number of the issues outlined within the Terms of Reference of this Inquiry.

The Department works closely with project proponents in state, territory and local governments to ensure that projects are delivered efficiently and achieve value for money, while maximising key project outcomes including improvements to productivity, economic growth, safety and the liveability of cities and regions. The Department also works with jurisdictions to develop strategic policy around infrastructure project delivery, project funding and financing, and transport networks.

This submission outlines the Department's view on best practice in procurement of public infrastructure projects, with the ultimate goal of achieving value for money for Australian taxpayers. In light of the Inquiry's Terms of Reference, we have identified four key areas in which to drive better practice in infrastructure procurement:

- selecting appropriate procurement mechanisms;
- applying national standards for best practice procurement processes;
- encouraging a competitive infrastructure market in Australia; and
- improving data collection and benchmarking.

1 Selection of appropriate procurement approaches

The Australian Government endorses the use of a range of procurement approaches for project delivery, including public-private partnerships, alliance contracting and traditional contracting, on the principle that procurement approaches should be selected on a best-for-project basis. Agencies should particularly consider approaches that allow for enhanced private sector involvement in the delivery of projects.

It should be emphasised that the selection of a procurement approach should take place after the investment decision to invest in a specific project has been made on the basis of its business case, including a rigorous cost-benefit analysis. While consideration of alternative procurement approaches is encouraged, investment decisions should ultimately be made on the merits and costs of a particular project, rather than its suitability for a particular procurement approach.

Following the decision to invest in an infrastructure project, project agencies should consider different methods to deliver the project. For major projects, this should take the form of robust, careful procurement options analysis. Guidance on procurement options analysis is provided as part of the National Guidelines for Infrastructure Project Delivery. Further detail on these guidelines is provided below.

The Department recognises that procurement options that involve the use of private finance, such as public-private partnerships, can represent substantial value for money when appropriate for a given project. However, the cost of different financing mechanisms should be taken into account when considering such options. International studies suggest that the cost of servicing private finance debt is substantially higher than government debt, with the UK National Audit Office finding in 2015 that the average cost of servicing private finance is approximately double that of government finance¹. Procuring agencies therefore must ensure that the benefits achieved through the use of private finance exceed the additional costs of servicing private debt.

2 National standards for procurement processes

Through the Council of Australian Governments (COAG) Infrastructure Working Group (IWG), Australian governments have developed national guidelines for the delivery of infrastructure projects to promote cross-government consistency and the use of best practice approaches. These guidelines (the National Guidelines for Infrastructure Project Delivery) have been developed with input from experienced practitioners from both public and private sectors.

The guidelines have recently been updated to reflect the recommendations made by the Productivity Commission in their 2014 *inquiry into Public Infrastructure*. The approaches to project delivery covered by the guidelines include:

- traditional contracting;
- alliance contracting and early contractor involvement; and
- public-private partnerships.

These guidelines should not be seen as exhaustive but are intended to inform the development of policy by individual jurisdictions and support agencies that deliver infrastructure projects. The policies, guidelines and requirements of individual jurisdictions take precedence to the practices covered in these documents.

These guidelines have been endorsed by the Australian Government, and can be accessed at <https://infrastructure.gov.au/infrastructure/ngpd/index.aspx>.

In 2016, the Australian Government will be engaging with industry to seek their views on the application of the updated National Guidelines for Infrastructure Project Delivery and their impact on the delivery of projects, including the cost of bidding.

3 Encouraging a competitive infrastructure market in Australia

Engaging international construction and finance firms in the Australian infrastructure market increases competition in design, construction, operation, and financing of infrastructure, as well as ensuring capacity to undertake major infrastructure projects is available in the market when needed, thereby driving better value for money.

¹ UK National Audit Office, 2015, *The choice of finance for capital investment*, London

In this context, it is critical to understand and address, where appropriate, barriers to entry for international participants in the Australian infrastructure market, as well as smaller or new Australian firms. In relation to procurement processes, these barriers can include the cost of bidding, a lack of understanding of tender requirements by new entrants, and perceptions that tender processes favour market incumbents.

Tender requirements need to be sufficiently detailed to assess which tenderer can most successfully deliver the specified infrastructure. On the other hand, overly complex tendering processes can make it difficult for new entrants to participate and win tenders, due to up-front costs and lack of familiarity with processes. Best practice therefore requires an appropriate balance between these considerations to both select the most competitive proposals while deepening competition within the market. This may involve providing comprehensive feedback for unsuccessful tenderers to allow them to improve their future bids.

4 Data collection and benchmarking

The Australian Government is committed to improving the delivery of infrastructure that is critical to efficient, productive and equitable operations of the Australian economy. Achieving this objective requires effective collection of data and careful examination of procurement processes to identify areas for improvement. Benchmarking procurement performance, by comparing performance across like projects and against best practice, are one method that can provide insights into areas of potential improvement.

Australian governments have recently cooperated to complete the first national pilot benchmarking of infrastructure procurement processes and construction costs as recommended by the 2014 Productivity Commission *inquiry into Public Infrastructure*. The benchmarking study was led by the Department's Bureau of Infrastructure, Transport and Regional Economics.

A summary report covering the main findings of the initial benchmarking analysis, and outlining plans for continued and improved future monitoring of infrastructure procurement performance and construction costs, was published on the Transport and Infrastructure Council website at <http://transportinfrastructurecouncil.gov.au/publications/>. A short overview of this analysis is provided below.

4.1 Benchmarking of procurement processes

In 2012, Infrastructure Australia recommended timeliness, quantitative and qualitative performance measures for major infrastructure procurements based on industry consultation. These measures and targets were used to benchmark a sample of 29 infrastructure projects from across seven jurisdictions, all undertaken since 2010.

Analysis of the procurement processes found the majority of the projects in the pilot study sample met most timeliness targets and most qualitative and quantitative performance measures specified by Infrastructure Australia. Project phases involving extensive client–contractor interaction (Interaction, Evaluation and Finalisation) were found to be most time-intensive, exhibited most time variation and had poorest compliance with targets.

The majority of projects also complied with planned quantitative and qualitative performance benchmarks, however, with two exceptions:

- almost 80 per cent of sampled projects reported at least one addenda for project changes or missing information; and
- approximately 57 per cent of sample projects reported at least one material change to terms or scope at the Request for Proposal phase.

These results highlight some areas for potential process improvement, particularly around client–contractor interaction phases. However, the data collected through the initial study provided no

information about the quality of agency procurement processes (including procurement team skills and agency systems) or the quality of procurement outcomes. For example, observed extended contractor interaction may have contributed to better project outcomes or improved project delivery efficiency, but this is not captured in the pilot study data. The report recommended inclusion of measures to also capture improvement in procurement processes and project outcomes.

4.2 Benchmarking of infrastructure construction costs

The infrastructure cost benchmarking pilot study presented ‘strategic’ cost benchmark measures, as recommended by the 2014 Productivity Commission *inquiry into Public Infrastructure*, from a sample of 65 separate road construction projects undertaken since 2010, drawn from across all eight states and territories. Thirty of the projects in the sample were from recently-completed projects, 26 projects were in-delivery and nine projects were at pre-delivery phase. Only completed projects and projects currently in-delivery were included in the benchmarks.

The main findings of the cost benchmarking analysis were:

- road class is the most significant factor in average project costs – average costs of urban and rural freeways/highways are around \$6.0 to \$6.5 million per lane kilometre, while lower standard rural arterials average around \$3.0 million per lane kilometre;
- project management costs typically comprise around 7 per cent of total costs while design and investigation costs typically comprise around 5–6 per cent; and
- the project sample provided no clear evidence of any time trend in average project costs over the last five years.

As far as the Department is aware, this is the first time that nationally-coordinated cost benchmarking has been undertaken in Australia and is a significant step to inform efficient and effective project delivery and identify areas of best practice. The experience from the cost benchmarking also suggests a need to collect additional information about projects (such as project type, construction methodologies, terrain, pavement type) to better understand the causes of cost variation across projects and jurisdictions, particularly for the small number of projects where costs differed significantly from the average for the class of road.

A brief review of overseas infrastructure cost benchmarking efforts yielded only a small number of studies that provided mixed results – which suggested that average Australian road project costs are below equivalent project costs in the United Kingdom but above project costs in four continental European countries. It is not clear, however, how comparable are the Australian and overseas projects and further analysis would be required to be more definitive.

All jurisdictions involved in the benchmarking noted the utility of the procurement and cost benchmarking analysis for improving the efficiency of procurement processes and ensuring value for money in infrastructure investment.

4.3 Next steps

As a result of the success of this initial benchmarking analysis, the Transport and Infrastructure Council has agreed to further develop benchmark measures in 2016 to improve and simplify procurement benchmarks and to undertake another round of procurement and cost benchmarking in 2017, allowing time for inclusion of a sufficient number of new infrastructure projects. Jurisdictions have further agreed to review and improve their procurement and cost management processes in light of these findings.

In addition to these benchmarking activities, there is an onus on all participants in infrastructure procurement to improve their collection and sharing of data on all aspects of infrastructure delivery. Better data and improved transparency will be vital for driving ongoing performance and cost improvements in infrastructure delivery.

5 Further research into best practice in infrastructure delivery

The Department has published two volumes of case studies for infrastructure planning and delivery. Key best practices identified in these case studies include that:

- projects that develop from long-term plans and which have robust business cases are likely to be successful;
- strong project governance arrangements mean strong project delivery;
- the procurement model should be chosen on the basis of project specifics and should rigorously follow established published guidelines;
- procurement arrangements should transfer risk appropriately in order to maintain value for money; and
- careful management of local and environmental impacts assists project delivery.

These findings are in line with the principles endorsed through the National Guidelines for Infrastructure Project Delivery.

The reports can be found at <https://infrastructure.gov.au/infrastructure/publications/index.aspx>.

I trust this information will help inform the Committee's inquiry.

Yours sincerely



Mike Mrdak

9 February 2016