

**Submission
No 27**

PROCUREMENT OF GOVERNMENT INFRASTRUCTURE PROJECTS

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NSW Inquiry into Procurement of Government Infrastructure

NSW Committee on Transport and
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1. Introduction

Notwithstanding the challenges associated with procurement of public infrastructure in NSW there are strong fundamentals that underpin the capacity of the private sector to work with the State in delivering the Government's infrastructure objectives over coming years.

The extent of private capital available for infrastructure outweighs, by a significant margin, the availability of projects within which to invest. This bodes well when combined with the competitive tension in the construction market which will work in favour of achieving positive value-for-money outcomes.

Our submission briefly considers the benefits of PPP projects for Government which we believe requires serious consideration of a review of each infrastructure project over a threshold of \$200M, to consider whether a PPP approach can provide better value-for-money than other traditional procurement approaches.

The submission also addresses the misconception that PPP procurement necessarily takes longer than other forms of procurement and requires resources that could be utilised elsewhere. This is not the case. PPP procurement does not need to be lengthy or costly, in fact the market participants would prefer both time and documentation requirements were reduced to lessen the cost of procurement for both the State and private sector.

Our submission outlines a range of ways where processes can be streamlined to reduce both time and costs and identifies other jurisdictions where this has been achieved successfully.

Plenary supports standardised documentation and templates to improve PPP procurement efficiency.

In the latter part of the submission we challenge the view that PPP's best serve larger infrastructure projects by noting the success both Canada and the US have had in utilising PPP procurement for smaller infrastructure projects, delivering greater contestability and delivery efficiency.

Plenary Group

In the past decade Plenary Group has been successful on 35 PPP projects with a market capitalisation of \$24B. It currently has 21 projects in operation and 14 in various phases of construction. Plenary Group is a specialist PPP development and investment business, looking to apply the knowledge and experience of its 180 professional staff to the delivery of public infrastructure.

Over the past decade Plenary has brought a unique model to the delivery of public infrastructure to that previously seen in Australia. Plenary is independent of both the investment banking model of PPPs – where the focus has historically been on capturing an immediate financial return by divestment – and the new wave of contractor owned PPP teams. Plenary understands that Governments are attracted to the opportunity of a genuine and meaningful long term partnership.

Plenary's long term investment and active management model has filled a niche in the Australian infrastructure market. By retaining long term equity in its PPP projects, and actively managing those projects, we become direct partners with Government agencies and with each public infrastructure operator.

This 'active equity' position provides a compelling incentive to tailor our services to the commercial environment and service needs of each project. It results in a positive experience for Governments, user groups and the recipients of core services who benefit from the success of the project.

It is an approach that has seen Plenary rapidly expand in the Canadian and US markets where it has offices in Vancouver, Toronto, Denver and Los Angeles. In the Asia Pacific region Plenary's office are located in Adelaide, Melbourne, Sydney and Brisbane and we maintain a presence in Singapore to ensure we are able to easily tap the wholesale banking sector headquartered there.

2. Best process of gateway decision making on the efficacy of public private partnerships compared to other procurement methods

Over the past twenty-five years the need to ‘catch up’ on infrastructure development has driven a series of alternative approaches to getting the most out of our public infrastructure dollar.

Public Private Partnerships (PPPs) have emerged as one of the most important of the new models by which governments have chosen to finance and procure infrastructure facilities and services.

That’s not to say the pendulum has swung wildly to private financing - quite the contrary, as the classic public provision model of Government planned, installed and financed infrastructure continues to characterise much of Australia’s publicly provided infrastructure.

Nonetheless, Governments of all political persuasions around the world have embraced at least some PPP procured projects. The reasons they do so are simple: when applied to the right projects, PPPs have been overwhelmingly positive.

This embrace is, in part, recognition of the greater levels of financial discipline and accountability that private sector participation imposes upon both those who conceive scope and specify infrastructure projects on behalf of government, and those from the private sector that procure and manage the provision of such essential infrastructure.

Research on Performance of PPPs

There have been several independent Australian studies which show that PPPs demonstrate clearly superior cost efficiency over traditional procurement and that - with respect to on-time delivery - PPPs are significantly more likely to be completed ahead of time than traditional.¹

Chart 1: Procurement Contract Cost-certainty Comparison

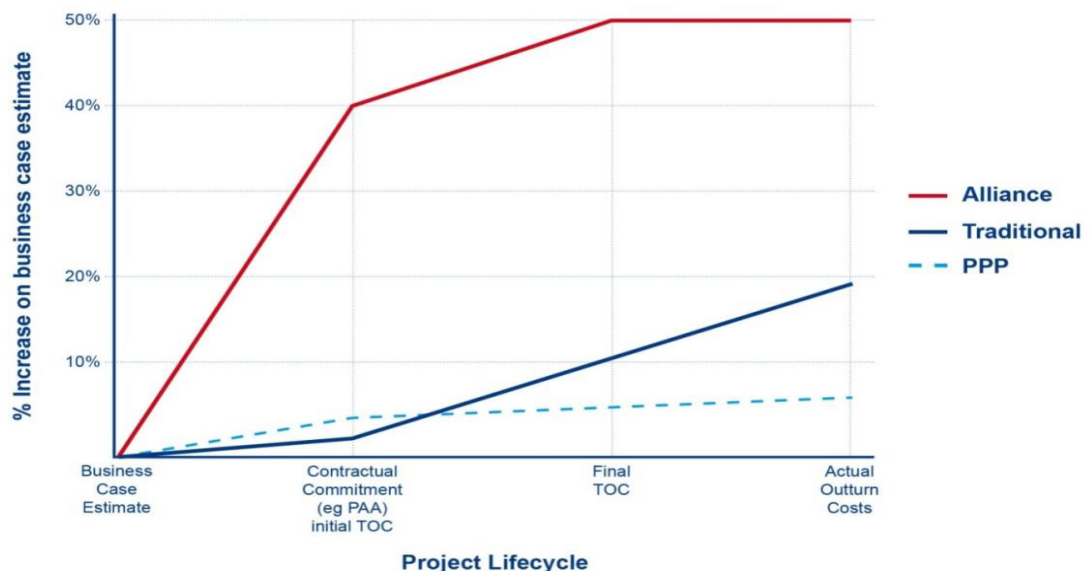


Table: Cost certainty for various delivery methods

Source: In Pursuit of Additional Value: A benchmarking study into alliancing in the Australian Public Sector,

¹ Performance of PPPs and Traditional Procurement in Australia, Allen Consulting Group, University of Melbourne, November 2007;
 Performance of PPPs and Traditional Procurement in Australia Infrastructure Partnerships Australia, Sydney, 2007;
 In Pursuit of Additional Value: A benchmarking study into alliancing in the Australian Public Sector, Melbourne University, Evans & Peck on behalf of the Inter-Jurisdictional Alliancing steering Committee, October 2009

In addition to the on-budget/on-time risk transfer for PPPs, Governments also typically transfer design cost risk, maintenance and refurbishment obligations over the full operating term and the obligation to meet the required standards which ultimately supports better services and public outcomes.

Research findings in Australia have recently been supported by the findings of the Lawrence National Centre for Policy and Management at Western University in Ontario.² This investigation found that when comparing PPPs to traditional forms of infrastructure procurement, PPPs (P3s) were generally superior because they brought to bear a specialised expertise, due diligence and accountability mechanisms that are not possible to replicate in the public sector.

It noted that the key advantage of the P3 approach is that it facilitates bundling of end-to-end services to a single winning private bidder, which in turn encourages an integrated, whole-of-life perspective to the project.

Here PPPs provide certainty as to the costs government will incur over the full term of the contract. This process of integrating the full design, construction, maintenance and lifecycle spending into a regular payment presents an altogether better proposition than the situation whereby maintenance and lifecycle expenditures can be overrun by new budget priorities when spending allocations are undertaken; leaving public assets to deteriorate earlier in their lifecycle than they should.

Gateway Decision Making

The evidence shows superior performance of PPPs relative to other procurement methods. There is a strong argument for the decision making on the efficacy of PPP procurement to turn, not on whether a PPP procurement approach should be used, but, on why government agencies would not procure a project using the PPP procurement.

To some extent this is an approach Canada has undertaken as a result of the Canadian Commonwealth Government's Economic Action Plan, 2013. This plan announced the implementation of a PPP Screen to be applied to projects with capital costs of more than \$100 million submitted by provinces, territories and municipalities for funding under the New Building Canada Fund.

Under the PPP Screen, public sector agencies procuring large infrastructure projects that present preliminary PPP potential are required to assess a range of procurement options, including a PPP approach, through both quantitative and financial analyses. This assessment is undertaken to determine whether a PPP approach can provide better value-for-money than a traditional procurement approach.

Plenary Group is an advocate of a PPP Screen in NSW where public sector departments and agencies would be required to undertake a process to assess whether a PPP is the best value-for-money procurement approach for their specific infrastructure project.

² *The Procurement of Public Infrastructure: Comparing P3 and Traditional Approaches*, National Centre for Policy and Management at Western University in Ontario, 2015

3. Best procurement process and documentation

Opponents of private financing in public infrastructure sometimes argue that PPP procurement can be too slow and too costly, for both the public and private sector. This is despite the demonstrated benefits in superior procurement performance and risk transfer achieved through PPPs and despite several failed processes where a non-PPP procurement process has been selected.

Plenary's submission addresses these views by identifying changed documentation requirements in this section and noting, later in the submission, that these challenges have already been overcome in other jurisdictions in Canada.

The premise of Plenary's submission is that PPPs in Australia can be streamlined to be cost and time efficient while retaining the superior time and cost benefits, risk transfer and service delivery outcomes that characterise this procurement process.

Reducing Bid Risk

It is worth noting that one of the key determinants of a sound PPP process is the capacity to resolve as many issues as possible in relation to the delivery of a project, this has the impact of taking risk out of a project and so, ultimately reduces the overall project price that consortium's bid back to Government.

Here the capacity to resolve issues rests with the expertise, experience and capacity of the State-side teams. The ability of project teams to respond fully and efficiently to more than one consortium's questions/issues will directly lead to more comprehensive bids that can be priced appropriately; the more issues are unresolved the more risk is priced into a project.

Governments need to resource and cultivate project teams; a strong procurement team with well-run interactives is best able to provide clear direction to bidders on what is important to the State as the client. It reduces risk, saves material costs and time by avoiding dead-ends and wasted effort during bid phases.

Reducing Bid Costs

As an overall statement, the largest driver of costs in PPP procurement processes is time, and the resource allocation needed to service that time. Improvement in the time taken to undertake processes would dramatically reduce the cost of PPP procurement on both the private and public sector side.

A standard procurement process takes 18-24 months from registration of interest to Financial Close. From the private sector's experience alone, this and generally involves c150 – 200+ people at peak. These people and their public sector counter parts cannot be easily reallocated during a procurement process.

It follows that shortening of the procurement process would lead to the biggest saving in bid costs – from both a private and public sector side. The key ways in which the State could drive reductions in time are from the following:

- Reducing the information requirements to the level required to select a preferred partner and not beyond to include information that won't have a material impact on capacity for decision making – saving time at both the RFP and post RFP phase;
- Use of good bid governance to ensure that bidders have full, and equal, information and so ensure the receipt of competitive bids at RFP submission that require minimal clarification, reducing the post RFP time;
- Use of consistent commercial positions for generic risks, to ensure that bidders and the State concentrate on the commercial issues unique to the project, saving time at RFP and post RFP phase;
- Increasing the pipeline of projects, so that the State side procurement teams are more familiar and confident in the understanding of the market to streamline PPP processes and eliminate the 'learning process' common to project team members when PPPs are only done on large projects or done occasionally by individual Departments.

Reducing Time and Cost through Streamlined Selection Processes

The primary purpose of the information required over the course of the RFP is to provide the State with sufficient information to select a preferred partner. In essence this requires the proposal to provide the State with confidence the proponent will ultimately deliver the outcomes and scope it has sought while transferring risk away from the tax payer. The State requires best value for money that delivers:

1. a design solution and construction methodology that meets the State's objectives;
2. the best possible operating methodology;
3. a Project Company structure robust enough to deliver the Project without intervention from the State; and
4. a Proposal that will reach Financial Close without a change in the price or commercial position.

The primary area where information requirements could be reduced without impacting on these objectives is in respect of design, construction and operations. Here the State asks for:

- Design drawings progressed to a level materially in excess of that necessary for firm pricing;
- Delivery programmes progressed to a level materially in excess of that necessary for firm pricing;
- Detailed descriptions of ordinary course of business activities that could be assessed via a capability evaluation (e.g. stakeholder management), noting that compliance could be ensured in delivery via the scope and performance requirements; and
- Management plans developed at bid stage to a level beyond those required to demonstrate the key elements of the construction and operational methodology.

Alternative approaches to reduce the level of material required to be assessed for a decision to be made and, so, achieve the same outcomes would therefore be:

- Design development only to the level necessary for the private sector to provide a firm price and the State to understand at a high level the final design outcome;
- Programme detail necessary to understand the key dates, critical paths and potential risk areas;
- EoI/capability style evaluation of 'ordinary course of business' activities, noting that the scope and performance requirements in these areas are already enforceable in delivery via the contractual arrangements;
- Management plans either not prepared at bid stage or prepared in outline level, noting that they are all required during the delivery phase (and often require major rewrites and further assessment at that time);
- Greater evaluation weight placed upon the robustness of the SPV to provide the State certainty in a scenario of reduced documentation at bid stage.

The level of information necessary for contractors to agree subcontracts and firm pricing would also suffice for financier due diligence. Accordingly the above approach would reduce procurement and bid costs while still enabling the State and financiers to have certainty with respect to the overall deliverability of the Proposal.

Lower level opportunities to deliver procurement and bid cost savings would include the consideration of electronic submissions, which have been successfully adopted in other jurisdictions.

4. Desirability of the standardisation of procurement processes and documentation

Plenary Group's primary experience of alternative procurement processes is from North America, and specifically British Columbia and Ontario in Canada.

Some of the key differences in the approach to processes exist in standardisation, design returnable requirements and bid cost compensation.

PPP procurement does not need to be as lengthy or as costly as it is in Australia. Other international jurisdictions have widened the projects done via PPP off the back of their more efficient processes, and so created the positive feedback loop of an experienced private sector and public sector. Smaller, simpler projects could be used as the test bed for a more streamlined approach.

Standardisation in International jurisdictions

Both the British Columbia and Ontario jurisdictions employ standard 'templates' for the returnable requirements and the Project Documents. These templates are used on every deal, with slight adjustments for the specific elements of a transaction (shown as blackline against the standard template).

Both the government and the market have become disciplined (after a strong stance by Government when it initially developed this template approach) around the commercial terms being 'non-negotiable', save where there is a genuine evidenced value for money difference. This process started with Government avoiding changes of its own, and then being strong in evaluation of commercial positions – the former step is as important as the latter in creating this environment.

The result is that across both consortium counsel and lenders counsel, the total legal expense for a consortium in the Australian environment at RFP stage (with corresponding increased costs for the D&C and O&M contractors, as well as the State itself) would be in the order of 5 times greater than in the Canadian environment.

Rather than a focus on variations in commercial terms, Canadian industry participants argue that the template process frees them maintain competitive tension through allowing greater concentration on the design and cost, as well as the project specific commercial positions.

5. Desirability of a standard national process and documentation for the delivery of government infrastructure within a federal structure

While Infrastructure Australia has produced a National PPP Policy Framework and has done significant work to achieve consistency across States and Territories, there still exist significant differences in the documentation required in each jurisdiction.

These include (but not limited to) different approaches applied by jurisdictions to capital contributions, bid cost reimbursement, compensation schedules and termination payments.

In addition to the obvious savings that exist in standardisation for both the private and public sectors, a standard national process and documentation for the delivery of government infrastructure would lead to some further key benefits for the market.

One of these would be the capacity for offshore participants to understand and participate in the Australian infrastructure market, effectively reducing the barrier to entry and linking the Australian infrastructure market into an internationally competitive environment.

In recent years we have seen these benefits in increased competition within the Tier 1 contractor market where, after a lengthy familiarity process by new off-shore entrants, we are now seeing greater contractor competition for projects leading directly to lower construction costs in the infrastructure market. This is a positive outcome for Government and taxpayers. National standardisation will only make it easier for off-shore participants to be involved.

A second benefit for the infrastructure market would be to facilitate mobility of experienced procurement staff around Australia to match demand for their expertise in projects across several jurisdictions.

Infrastructure Australia has produced a National Infrastructure Construction Schedule however, less planning goes into the mobility of what is effectively a key counterparty risk for the private sector - experienced project procurement professionals. The confidence of bidders and Governments would be enhanced if there was greater mobility between jurisdictions and national standards, in documentation and process, would facilitate this.

A further benefit would be the capacity for national standards to allow greater familiarity for both national and off-shore equity participants to invest in Australian infrastructure projects. This will be a far more attractive option for equity than the current position of having to understand nuanced differences across all eight state and territory jurisdictions as well as those that fall under the auspice of the Commonwealth. This would lead to greater interest from off-shore equity investors attracting greater investment dollars to Australia and potentially creating a stronger secondary market in infrastructure projects.

6. Methods to minimise the cost of contractors tendering for the supply of services with respect to government infrastructure

As noted earlier the key driver of bid costs is time. Shortening of the procurement process would lead to the biggest saving in bid costs – from both a private and public sector side. One of the key ways in which the State could drive reductions in time is through reducing the information requirements to the level required to select a preferred.

Here the State performing common activities and hence avoiding duplication of identical activities by multiple bidders would be one of these initiatives.

Due diligence requirements that could be completed by the State and issued to all bidders include:

- Site surveys, ideally in 3D, suitable for importing into CAD and drafting applications that identify existing infrastructure and utilities, notable features, site boundaries and so on;
- Geotechnical and contamination surveys. In addition to interpretative reports that aggregate previous investigations, a useful approach is to consult with bidders to develop an agreed scope (and time for provision) that positively contributes to the certainty of the bid;
- Environmental information, such as flood data, that is applicable to the project;
- Condition assessments where there are existing assets that the State is seeking to be transferred to the successful bidder;
- Documentation of easements, reservations, ownership (or control) and other land title and tenure information;
- Utility connection points and capacities; and
- Planning, heritage, native title and other relevant site information.

But for due diligence items such as those listed, bid (and project) costs would only be reduced on the basis that bidders are able to either: a) place reliance on this information; b) be granted relief under the Project Deed, or c) have the engagement of the consultant who prepared the reports novated across to them if successful.

Without those steps, D&C Contractors will be unable to receive corporate approval to accept the relevant risk, and will therefore include both the costs of performing their own investigations post Financial Close, and contingency for the associated risks, within their Contract Price.

In the case of one recent NSW procurement, the inability to rely on the information provided, such as the 3D utilities model, meant that either validation or conducting of new investigations was included in the bid pricing of all tenderers.

As this information is general in nature, of universal application and describes the existing conditions, it is unlikely to constrain innovation. In fact, the converse may well be true as all bidders receive the same information.

The provision of common due diligence items, with reliance, at the outset of a project could allow greater innovation as the focus moves from the element being an unknown but potentially major risk that attracts significant corporate attention, to being an item that is somewhat understood and mitigated, allowing the opportunity to innovatively develop more cost effective or lower risk approaches.

Pipeline

Inevitably the wider issue of project pipeline has to be addressed when discussing contractor costs. Plenary's observations in Australia and Canada are that, where a consistent and predictable pipeline of projects exists then contractors are able to reduce their sub-contractor costs by negotiating a price over several projects. A simple economy of scale argument, where sub-contractors are be prepared to take more risk when negotiating prices with head contractors, underpins this rationale. We address pipeline issues further in section 7 in relation to contestability.

7. Methods to achieve optimal contestability in tendering for the supply of services with respect to government infrastructure

Contestability is a key driver of successful PPP outcomes in infrastructure procurement. PPP procurements see intense competition for the best project solutions across all of the major disciplines of design, construction, financing, operations and facility management. In a properly run PPP procurement with an even playing field, the intensity of competition is unrivalled as consortiums place their trust in the integrity of, what has proven to be, a relentless and probity driven process.

As noted there are a number of suggested approaches we would be in favour of that would in their own right deliver greater contestability:

- A PPP Screen would encourage Government Departments to justify why they would select a less contestable procurement process if it offered less value for money
- Reduced bid costs would increase the number of companies that would consider participating in PPP infrastructure processes
- Similarly a reduction in information requirements would allow earlier decision making and improve the opportunity cost ratio, thus expanding the pool of participants
- Standardised processes would reduce the barriers to entry, and
- Due diligence requirements provided to all bidders to ensure full and consistent information provided to all bidders at same time

Further contestability can be achieved through bid cost reimbursement which has the effect of encouraging consortium teams to form and will most likely lead to at least three quality bidders in a short list. On this latter point there is a consolidated view within Plenary and the wider market that optimum competitive tension comes from the State shortlisting 3 bidders.

We have seen on more than one occasion the influence of bid cost reimbursement in encouraging companies to join bidding consortiums which have gone on to deliver the best-value for money (and winning) bid to Governments; an opportunity that would have been lost to the State without the incentive of bid cost reimbursement.

While all of these factors will add to the contestability within the PPP procurement environment the greatest contribution will come from increasing the pipeline of projects and ensuring greater range of project sizes are brought to the market. This will build market knowledge, provide confidence and encourage the private sector bidders to increase staff resources and investment capacity.

By way of comparison the Canadian market has achieved financial close on some 220 PPP projects since 2006 while the Australian market, an earlier adopter, has reached financial close on 136 projects since the mid-1990s.

The contestability upside of this greater pipeline can be seen in the greater competition for debt capital with a strong and active bond market competing with the bank market; significant influx of both private and public sector project teams; downward pressure on procurement costs due to streamlined processes; attracting significant international investors to compete with existing Canadian investor market.

Encouraging Contestability - Pipeline Expansion

Plenary sees significant opportunity to increase contestability in the PPP market by applying PPPs to the wider range of smaller projects. The idea that PPPs are only suitable to larger infrastructure projects cannot go unchallenged given how successfully they have been in delivering contestability and value for money to taxpayers when applied to smaller infrastructure projects in North America.

Here we note the Canadian market in particular where PPPs in this jurisdiction have been, on average, smaller than their Australian equivalent and inclusive of many more projects in the \$200M to \$500M price

range. A streamlined, shorter procurement process, incorporating template documentation where appropriate, has led to a more experienced and confident public sector procurement process and a more competitively robust market overall.

The US market has also started utilising PPPs for smaller construction projects with significant success. The impact has been to increase contestability and allow a wider range of smaller sub-contractors to participate in the market.

Moreover the aggregation of smaller projects into one large PPP has the capacity to speed up the delivery of infrastructure projects, directly contradicting the view that PPP procurement is only for larger infrastructure and that procurement timeframes are too long and inefficient for smaller infrastructure.

Plenary believes its Pennsylvania Rapid Bridge Replacement Project is an appropriate case study to encourage greater utilisation of PPPs to expand the PPP pipeline to increase contestability and speed up the delivery of smaller, economically important, local infrastructure projects.

Pennsylvania Bridges PPP Case Study

The project includes the replacement of 558 bridges across Pennsylvania in the US, making a big commitment to reducing the large backlog of structurally deficient bridges in that State. The private sector consortium³ is managing the financing, design and construction of the replacement bridges and will then be responsible for their maintenance for 25 years after construction.

The average Replacement Bridge under the project is expected to cost just \$1.6 million, as compared to the Government's estimate of \$2 million per bridge under the traditional delivery option, a significant saving for Pennsylvania taxpayers, even before factoring in the 25 year maintenance and rehabilitation "warranty".

As with any PPP, there are strict availability, performance, and hand-back requirements on all of the bridges, ensuring a rigorous maintenance regime for the life of the contract. The project is financed through a combination of milestone payments, availability payments, tax-exempt Private Activity Bonds⁴.

Early Completion for Efficient Economic Impact

The project will deliver the full complement of bridges eight months earlier than required by the Government.

Moreover, construction of all 558 bridges is scheduled to be completed within 36 months of commercial close. Whereas the Pennsylvania Government projected that as part of their traditional sequential procurement and construction program it would take up to 20 years to replace all of the bridges that are a part of this project.

When addressing multi-asset, multi-location projects in future, the timeliness and economic impact of the PPP approach that has been applied to the Pennsylvania Bridges Project will likely overrun the application of a sequential roll-out of construction.

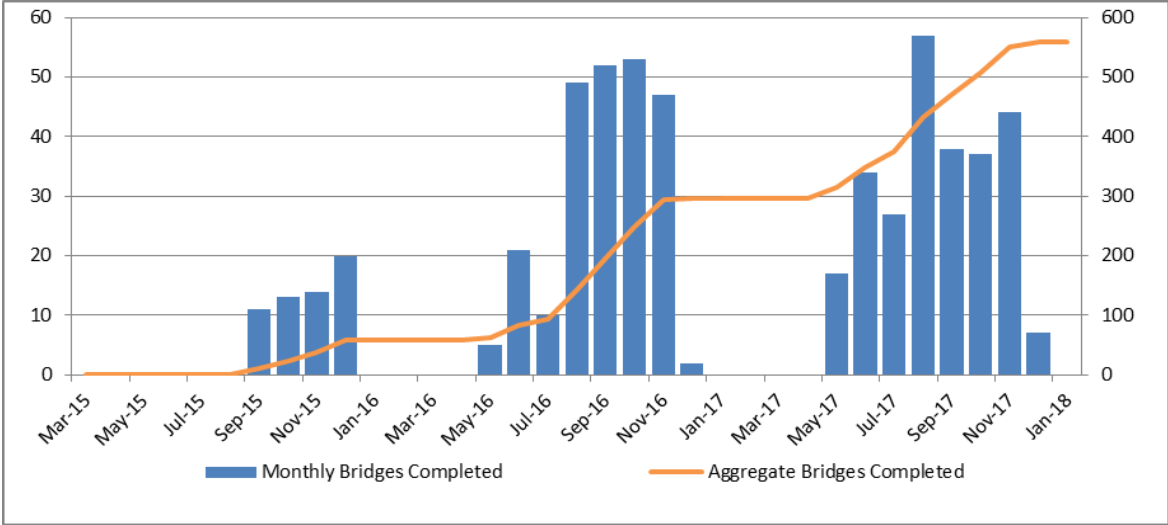
This is the first of 4 such projects in Pennsylvania and the growing anecdotal evidence is that the civil infrastructure market is openly discussing its application to other multi-locational projects.

The bridge completion schedule is shown in the chart below where construction over the three year period ramps up during May to December while it slows for the harsh winter months; intensive construction scheduling and application of resources allowing their rapid delivery..

³ Plenary Group with Walsh Keystone Partners

⁴ Private Activity Bonds are debt instruments issued by or on behalf of State or local governments whose proceeds are used to construct projects with significant private involvement. Their strategic goal is to increase private sector investment in public serving assets by reducing financing costs because of an exemption to federal tax. In 2014, the 50 states and D.C. received US\$34.53B of new volume cap allocation and carried forward US\$59.12B from 2011 to 2013; states ultimately reported cap-subject PAB issuance of US\$11.61B for the year.

Chart 2: Bridge Completion Schedule



Driving the Infrastructure Dollar Further

The project is the first multi-asset PPP to be undertaken in the US, allowing Pennsylvania to replace and maintain a significant number of bridges in a more economical way.

There is considerable relevance for the NSW roads and bridge construction and maintenance programs given these projects are widely dispersed and, so, may benefit by being packaged to attract the risk transfer and value for money benefits that apply to the PPP model and private financing.

This applies not only to the design and construction timeframe but also to the ongoing operations and maintenance. The winning consortium will be responsible for the structural performance of the bridges aligning their payments and financial incentive to the objectives of the Pennsylvania Government and taxpayer.