

INQUIRY INTO CROSS CITY TUNNEL

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Theme:

Summary

24 May 2006

The Director
Joint Select Committee on the Cross City Tunnel
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Dear Director,

INQUIRY INTO THE CROSS CITY TUNNEL – LANE COVE TUNNEL: SUBMISSION

Thank you for your invitation of 20 April 2006 to make a submission on terms of reference (g) to (j).

ABN AMRO's submission provides information on the approach to the tender process, the financing elements of the Lane Cove Tunnel and analysis of Public Private Partnerships (PPP). Connector Motorways and our Lane Cove Tunnel Consortium (LCTC) partners Thiess Pty Limited and John Holland Pty Limited will make separate submissions, addressing other elements of the project.

ABN AMRO has been involved in a number of privately financed road projects in Australia including the Lane Cove Tunnel and M2 Toll Road in Sydney, and the CityLink Toll Road in Melbourne. In addition, in May 2006, the Brisbane City Council awarded the RiverCity Motorway consortium (of which ABN AMRO is Financial Advisor and debt and equity underwriter) the right to construct and operate the concession for the North South Bypass Tunnel in Brisbane.

ABN AMRO is a leading financier of social and economic PPP in Australia. ABN AMRO has delivered the first PPP in each of the jurisdictions that have adopted PPP procurement (Victoria, NSW, Queensland, NT and WA) and numerous other PPP projects. ABN AMRO is also co-sponsor of a consortium short-listed for the Commonwealth's first PPP, Defence Headquarters Joint Operations Command. The sectors in which ABN AMRO has delivered successful PPPs include schools, TAFE, hospitals, courts, public sector accommodation, communications, roads and water.

Background

Before addressing the terms of reference, we provide the following overview of the project's corporate, contractual and financial structure to assist the Committee to understand our role.

The Lane Cove Tunnel Consortium (now Connector Motorways Group) was formed by ABN AMRO Australia Limited, Thiess Pty Limited and Transfield Holdings Limited. John Holland Pty Limited joined the consortium during January 2003.

The key aspects of ABN AMRO's role were:

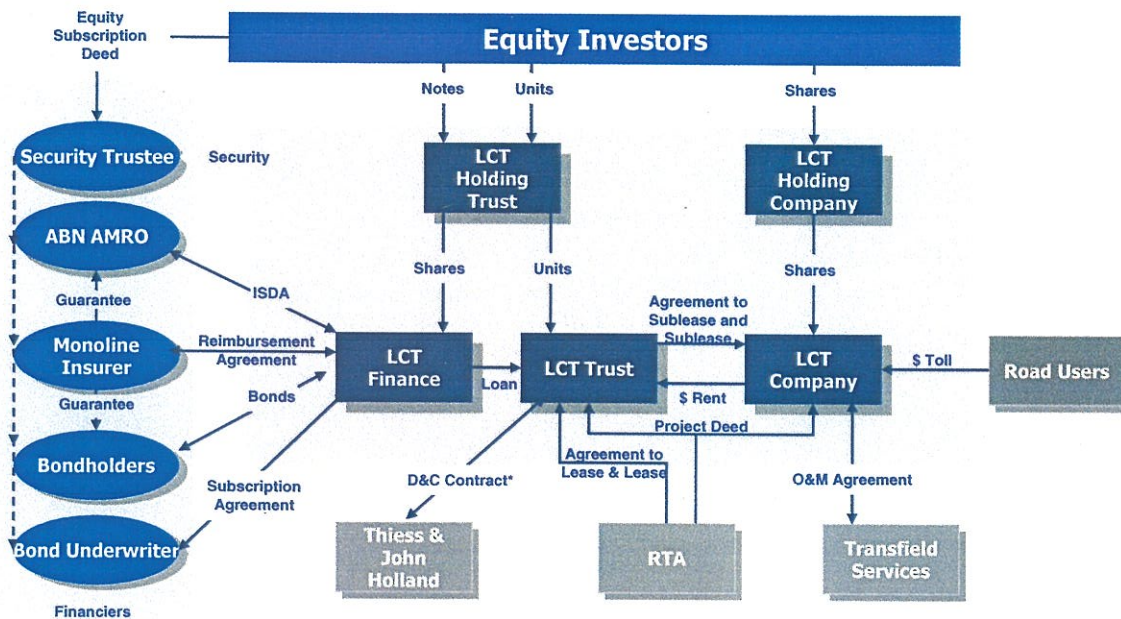
- Acting as a Joint Consortium Sponsor

- Acting as the sole Financial Advisor to the Connector Motorways Group, which included development of the capital structure for the group,
- Underwriting the entire debt capital raising of \$1.1b.
- Underwriting 21% (\$165m) of the project's equity investment;
- Management of the credit ratings process with the credit rating agencies, and monoline insurer;
- Development of the project financial model; and,
- Management of the commercial/legal documentation process.

ABN AMRO remains a Financial Advisor and Bond Manager to the Connector Motorways Group and has now sold the equity component it held to a number of investors.

Financing Summary

The figure below represents the project's corporate, contractual and financial structure in summary form.



The above diagram summarises:

- the five entities comprising the Connector Motorways Group;
- the stapled structure underpinning the ownership of the Project; and
- Connector Motorways Group granting security over its assets, to the Security Trustee, for the benefit of the Financiers

In addition to the equity raised from the Equity Investors, CMG issued the following Bonds to finance the design, construction and operation of the Project.

Bond	Description of Bond	Basis of Interest	Issue and Subscription Date	Tenor to Scheduled Maturity Date (Years)	Tenor to Final Maturity Date (Years)	Proportion of Total Debt	Issue Amount Face Value AUD (\$m)
Bond 1	Inflation Linked Annuity Bond	Real	9 December 03	25	25	11%	126.8
Bond 2	Inflation Linked Capital Indexing Bond	Real	9 December 03	16.75	18.75	10%	112.8
Bond 3	Nominal Bullet Bonds	Nominal/Fixed or Floating	9 December 03	10	12	39.5%	451.2
Bond 4	Nominal Bullet Bonds	Nominal/Fixed or Floating	9 December 04	7	9	39.5%	451.2
Total						100%	1,142

The Tranche 1, 2 and 3 Bonds were issued at Financial Close and the Tranche 4 Bonds were issued one year after Financial Close in December 2004. The proceeds of the bonds are being used, together with the equity, to fund:

- upfront costs, fees and expenses;
- a variety of reserves including, liquidity, ramp-up, debt service; and
- construction drawdowns payable to the D&C Contractor.

Having regard to the construction and patronage risks associated with the Project, Connector Motorways Group's reserves, covenants and undertakings have been structured so the bonds (without regard to the guarantee provided by the monoline insurer) obtained an investment grade rating from the following rating agencies:

- Standard & Poor's BBB-;
- Fitch Ratings BBB-; and
- Moody's Investors Services Baa3.

In addition, the bonds have received the following ratings by virtue of the guarantee:

- Standard & Poor's AAA;
- Fitch Ratings AAA; and
- Moody's Investors Services Aaa.

Turning then to the terms of reference.

Terms of reference (g) - the role of Government agencies in relation to the negotiation of the contract with the Lane Cove Tunnel Consortium

ABN AMRO's and LCTC's interaction with NSW Government agencies during the tender process was governed by the terms of the Request for Proposal for the project. As part of the Request for Proposal, all members of LCTC, including ABN AMRO, were required to direct all correspondence and submissions in relation to the tender exclusively to the Roads and Traffic Authority (RTA) by way of courier, facsimile or email through an agreed LCTC representative. This protocol was strictly adhered to during the tender process. As such, the first time LCTC representatives met with RTA face to face after the commencement of the tender process was in October 2003 after LCTC had been nominated as the preferred tenderer.

Prior to October 2003, all negotiation had occurred by way of exchange of marked up project documents along with accompanying correspondence.

Further, all interaction with other Government agencies that entered into interface agreements with LCTC was handled by RTA during this period, and not by LCTC. RTA was the single and only point of contact with Government. LCTC was provided with draft agreements to consider, resulting from RTA's negotiations with other Government agencies. Consequently, LCTC and ABN AMRO were not involved in the determination by RTA or any of the other Government agencies of positions taken by them in relation to the various project documents.

In addition, LCTC and its contractor and financier partners were required to enter into a Commitment Deed Poll in September 2003, pursuant to which they confirmed their willingness to transact with the RTA based on a set of agreed project and finance documents annexed to that Commitment Deed Poll. Given the level of finality and certainty created by the commitments made under that Commitment Deed Poll prior to the announcement of LCTC as the preferred tenderer, there were relatively few matters to be settled or negotiated after that announcement.

All negotiations and other dealings were conducted in a professional manner on a fully arm's length basis.

An overview of the procurement process and the structures involved is available in the *Lane Cove Tunnel: Summary of contracts* document issued by the RTA in July 2004 under the *Working With Government: Guidelines for Privately Financed Projects*.

Terms of reference (h) – The extent to which the substance of the Lane Cove Tunnel was determined through community consultation

As a party engaged in a commercial negotiation with the RTA which transacted with LCTC on behalf of all Government agencies, we would regard it as a matter for RTA and Government to ensure that the parameters of the Project were reflective of the degree of community consultation which it considered necessary and desirable, particularly in the formulation of the Environmental Impact Statement that had been prepared by RTA prior to the commencement of the tender process.

We note that under the Request for Proposal all proposals were required to comply with the requirements of relevant environmental documents and substantially comply with the scope of works and technical criteria.

In that regard, LCTC submitted a range of both financing and engineering options to RTA in its tender submission. It was the RTA's decision to proceed with an option that did not require a revised Environmental Impact Statement as it fell within the parameters of the existing Environmental Impact Statement that had been prepared by RTA prior to the commencement of the tender process.

Terms of reference (i) – the methodology used for tendering and contract negotiations in connection with the Lane Cove Tunnel

The methodology employed by RTA was that described in our response to paragraphs (g) and (h). The methodology would appear appropriate for a project of this size and complexity, but we would regard it as ultimately a matter for Government.

Terms of reference 1(j) - other related matters

In this part of our submission we would wish to make some comments on the issues of PPP, which might be of assistance to the Committee in its deliberations. Copies of the publications referred to are attached.

Better value for money is the policy driver for PPPs

Each of the PPP policies in Australia is underpinned by the requirement that PPPs be used only if they offer better value for money for the public sector. This ensures that PPPs are only used in appropriate circumstances. A key principle that is followed to achieve value for money is to allocate each of the risks of a project to a party best able to manage that respective risk. Partnerships Victoria has assessed that, on average, optimal use of PPPs will see around 10% of public sector infrastructure privately financed.

Reviewing historic performance of traditional procurement compared with PPPs

To date there has only been one empirical review of a broad range of PPP projects in Australia, the *Review of Partnerships Victoria Provided Infrastructure* (GSG/Peter Fitzgerald for the Victorian Treasurer, January 2004). This review covers the first eight projects delivered by Partnerships Victoria using PPP. We are not aware of any similar review of a range of traditionally procured projects in Australia.

A comparative review of both PPPs and traditionally procured projects was completed for Treasury in the UK by engineering firm Mott MacDonald: *Review of Large Public Procurement in the UK*, July 2002 ("Mott MacDonald Report"). The Mott MacDonald report identifies a valuable concept in the measurement of public sector procurement of infrastructure, "optimism bias", which is defined in the report as:

[T]he tendency for a project's costs and duration to be underestimated and/or benefits to be overestimated. (Mott MacDonald Report, page S-1)

Mott MacDonald demonstrates that in the UK optimism bias is significantly greater using traditional public sector procurement compared with PPP/PFI style procurement, where optimism bias is almost eliminated (table 3, p.14).

One of the main recommendations of the *Review of Partnerships Victoria Provided Infrastructure* was that:

[Victoria] should sponsor a Review of Major Projects to evaluate the performance of project procurement and delivery, and develop an empirical database of risk components. The study would mirror the approach taken in the UK Mott MacDonald Report (*Review of Large Public Procurement in the UK*, July 2002). It might involve a review of at least 20 projects over say \$20 million across a range of sectors. It might also involve other jurisdictions and be sponsored by the proposed National Council on PPPs.

The then proposed National Council on PPPs is now established as the PPP Forum. Given that the average value of PPPs is rising and some jurisdictions have put a \$100 million floor on

transactions it may be worth amending Mr. Fitzgerald's \$20 million recommendation accordingly.


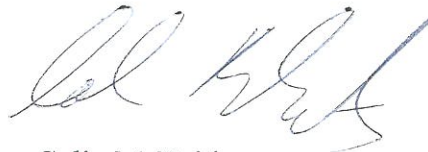
A more recent and more succinct review from the UK is a Report by the UK Comptroller and Auditor General, *PFI: Construction Performance*, February 2003. This report demonstrates the price and time benefits to the UK public sector at construction stage since the UK's Private Finance Initiative was introduced.

Performance Audit of NSW's New Schools Privately Financed Project

A recent review of a PPP project in Australia is the *The New Schools Privately Financed Project Performance Audit* report conducted by the NSW Auditor General, March 2006. This report reviews the first two Schools PPP projects in Australia, both of which are being delivered by ABN AMRO financed consortia. The NSW Auditor General estimated that the NSW Government will save 7% (\$10.4m) using PPP for the first nine schools, and save 23% (\$45.1m) for the subsequent nine schools compared with the estimated cost of traditional public sector procurement. In addition, the Auditor General found that the first nine schools were opened one or two years earlier than would have been the case under traditional procurement.

Please do not hesitate to contact me if you require clarification or further information.

Yours sincerely


John Martin
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ABN AMRO Australia
Colin McKeith
Head of Global Markets
ABN AMRO Australia

Attachments

- *Review of Partnerships Victoria Provided Infrastructure* (GSG /Peter Fitzgerald for the Victorian Treasurer, January 2004)
- *Review of Large Public Procurement in the UK* (Mott MacDonald, July 2002)
- *PFI: Construction Performance* (Report by the UK Comptroller and Auditor General, February 2003)
- *The New Schools Privately Financed Project* (Performance Audit report conducted by the NSW Auditor General, March 2006)