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Request for public comment:  
**Future direction for Victorian public  
private partnerships**

Committee for Melbourne submission

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## 1. About this submission

<b>Section 1</b>	Introduces the submission and refers to previous relevant documents produced by the Committee for Melbourne.
<b>Section 2</b>	Outlines some of the key issues and themes that sit outside the specific discussion points raised in the Consultation Paper.
<b>Section 3</b>	Responds to the Introduction in the Consultation Paper.
<b>Section 4</b>	Responds to Chapter 1 in the Consultation Paper.
<b>Section 5</b>	Responds to Chapter 3 in the Consultation Paper.
<b>Section 6</b>	Responds to Chapter 4 in the Consultation Paper.
<b>Section 7</b>	Responds to Chapter 5 in the Consultation Paper.

### 1.1 About the Committee for Melbourne

The Committee for Melbourne (the Committee) is an apolitical not-for-profit, member network that unites a cross-section of Melbourne's leaders and organisations to work together to enhance Melbourne's economic, social and environmental future.

Our aim is to ensure Melbourne's challenges and opportunities are tackled and grasped in ways that keep our city vital, inclusive, progressive and sustainable for the long-term.

Our members represent the highest levels of over 150 organisations drawn from the city's major companies, academic institutions and civic organisations across a broad range of industries. We represent no single interest and seek to challenge conventional thinking and develop innovative policy that continues to enhance the world's most liveable city.

Recently, in response to member concerns about the rate of infrastructure provision in Victoria, the Committee established a member Taskforce to focus on infrastructure funding and financing. The Taskforce is mandated to lead discussion, develop policy Committee policy and to suggest new reform initiatives to key decision-makers to advance critical infrastructure projects for the State.

The Taskforce is comprised of members with expertise across the infrastructure spectrum from finance and procurement to design and construction.

### 1.2 Contributions and references

This submission has been developed with the support of the following member organisations: Abigroup, Bates Smart, Corrs Chambers Westgarth, Ernst & Young, GHD, PwC, and the Committee's Infrastructure Funding and Financing Taskforce work, in particular, the following reports:

- Discussion Paper on Funding & Financing Infrastructure in Victoria  
*Committee for Melbourne* (2012) - **see Annex 1**
- Moving Melbourne – A Transport Funding & Financing Discussion Paper  
*Committee for Melbourne* (2012) - **see Annex 2**

## 2. Key issues and themes

The long term success and liveability of Melbourne - and subsequently Victoria - is connected to the quality of its infrastructure and service provision.

Victoria's infrastructure requirements are well-documented. There are urgent requirements in freight and passenger transport and social infrastructure, particularly in growth corridors. Together, State and local government are searching for the means to provide this infrastructure. The State government, and to a lesser extent local government, is investing in infrastructure but the rate has lagged behind the requirement.

The detriment of inadequate investment in infrastructure is also well-documented, specifically the constraints on economic activity, lower productivity and competitiveness, reduced amenity for users, and declining social equity. Rather than conserving resources, low levels of investment impose substantial costs and ultimately Victoria's economy will be smaller than it otherwise would be. Delaying investment in the legacy stock also introduces higher whole of life costs because assets need to be intensively maintained or renewed to extend their useful lives.<sup>1</sup>

Generally speaking, the Committee believes the proposed reforms are a positive step towards improving the PPP procurement process and maintaining the ongoing viability of PPPs as an important procurement and delivery method for much needed infrastructure development in Victoria. Steps to streamline the procurement process, with a view to decreasing the costs of bidding, can only promote competition in the PPP market and increase Value For Money (VFM) for the Victorian Government and taxpayers.

### 2.1 Skills & Governance

While it is critically important for Government to have appropriate structures and processes in place to ensure effective project delivery, one of the key ways to ensure effective, efficient and competitive outcomes is to ensure that the people charged with the management and oversight of project procurement have the best possible level of skill and experience to deliver the project.

Even with good structures and processes in place, a strong project leadership team is critical to deal with - in a timely and effective way - the unique set of issues and challenges each project throws up during the course of procurement, and which cannot always be anticipated at the outset.

Projects that are ultimately successful are those projects that have strong leadership who are able to respond to new and complex issues in real time and in a facilitative way. Significant effort should be placed by Government on the development and retention of people with appropriate skills. This might include formal or informal training and mentoring and considering the governance and remuneration structures that would help support the hiring and retention of key people.

The governance structure of a project itself is also critically important in achieving efficient and effective delivery. The most beneficial governance structure is one that involves the oversight expertise of professionals with significant experience for example, above senior bureaucratic and ministerial members who have a level of ownership of the project but without undue layers of

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<sup>1</sup> *Committee for Melbourne, Discussion Paper on Funding & Financing Infrastructure in Victoria (2012)*

bureaucratic structure (see case study on Scottish Futures Trust). A governance structure which allows the project team to engage with key decision makers in response to the real time demands of the project will better support Government project teams in delivering, responding to private sector innovation, and addressing key issues at an early stage.

## 2.2 Integrated Infrastructure Delivery Organisations

The Committee recognises the significant expertise, skills and capability in the Victorian Government in relation to infrastructure development and delivery. However, increasingly government in Australia and internationally has sought to develop more integrated delivery capability.

The UK, Scotland, Canada and (most recently) New South Wales, have all developed broader infrastructure organisations within government to improve the way infrastructure is procured and maintained, to drive efficiency and to integrate funding, financing and delivery. These organisations are taking a leading role in the implementation of government’s infrastructure plans. In particular Infrastructure UK, the Scottish Futures Trust (SFT) and Infrastructure NSW are designed to better link up government, to better engage with the private sector and to provide proper integration between infrastructure programs and the myriad activities needed to support them. For example, the SFT has developed the Tax Incremental Financing (TIF) model currently being used in Scotland. This included developing the concept, managing the legislative changes required, developing a procurement program, and now, overseeing projects during the delivery phase.

### Case Study: Scottish Futures Trust

*The SFT is an organisation (akin to a Statutory Authority) which is responsible for the development of Scotland’s infrastructure policy; for the development and assessment of projects and programs; for developing new funding models and for advising government on all matters related to infrastructure. It has championed the TIF model which is now in use in Scotland and has developed a new, not for profit, PPP model, which is being used to deliver new schools. It has a workforce comprised of senior professional staff from the infrastructure arena, including financiers, lawyers and engineers.*

*The SFT cites the following:*

*‘SFT is committed to saving taxpayers’ money and works with the public sector to deliver the best possible value where money is being spent on bricks and mortar. SFT currently leads or supports a portfolio of projects to the value of £9bn and last year it delivered £129m in savings and benefits, which represents a 16% increase on the £111m savings it made during 2009-2010<sup>2</sup>.’*

*Some of the successes of the SFT include:*

- *Development and promotion of a bespoke procurement model for Scotland’s PPP projects. The Not for Profit Distributing Organisation (NPDO) model is similar to normal PPPs but limits private profits and recycles ‘super-profits’ into projects. This model has reached financial close on a number of projects;*

<sup>2</sup> <http://www.eastlothiancourier.com/news/haddington/articles/2012/05/03/428298-hardup-nhs-committed-to-new-community-hospital/>

- *The SFT was the first region in the UK to develop:
 
  - TIF legislation;
  - a program of projects; and,
  - the structures;
 which are being used to deliver a number of projects. The legislation has passed and the first projects are in progress.*
  
- *Developing a whole of government framework for asset management and investment in the public sector.*

*The SFT is staffed by a senior team of professionals with significant private and public sector experience in the delivery of infrastructure projects. The SFT has a team of around 35 people working to increase the efficiency and effectiveness of infrastructure investment in Scotland. They focus on a number of areas including extracting value from existing infrastructure; developing ‘traditional’ projects and working to enable investment in new sectors – in particular renewable energy.*

*The stated aim of the SFT as stated in SFT’s 2010-2011 Business Plan is to improve the efficiency and effectiveness of infrastructure investment in Scotland by working collaboratively with public bodies and industry, leading to better value for money and ultimately public services.*

We recognise the strength of the State’s infrastructure policy and delivery capability and significant track record of success. However, we recommend that government reviews the benefits and risks of these different organisations and considers whether there are augmentations or amendments that would improve infrastructure delivery capacity and capability in Victoria.

### **2.3 Attracting international players**

A key constraint for very large projects with significant capital requirements is the availability of contactors with sufficient balance sheets to support the project. If Government requires a competitive process of 2 to 3 bidders, 2 to 3 contractors (or more, if contractors are acting as part of a joint venture) with very strong balance sheets will be required to bid for the project.

Each contractor bidding on a project will be asked to accept significant risk in relation to the project. To protect against the event that any of these significant risks materialise, financiers and equity investors will require contractors to have sufficient balance sheets and an appropriate corporate structure which can provide the required level of performance bonding and parent company guarantees. Accordingly, due to these financier and equity investor requirements, this contractor role is generally limited to tier one contractors and the number of these contractors actually participating in the Australian PPP market is limited. There are, however, a number of international contractors who would add significant balance sheet depth to the Australian market. Although there is a high level of interest in the Australian market from international contractors, a number of barriers to entry currently exist.

One of the most significant barriers to entry for the Australian market is Government’s history of almost always short listing consortia with the same tier one contractors due to their experience and

track record within the Australian market. This prevents international contractors from building their own experience and reputation within the Australian market.

If Government was able to incentivise the entry for new participants into the Australian market, including to joint venture with existing players, this would provide long term benefit to Governments as a whole. In order to deliver a number of proposed projects that have significant capital requirements, Government will need to address this issue.

In the short to medium term, it may be appropriate to explicitly recognise the need to incentivise new entrants into the Australian market during bid evaluation. Additionally, it may be beneficial to allow new entrants to gain experience in smaller projects to enable a history of participation in the Australian market prior to the larger projects coming to market, as such projects will no doubt benefit from a contractor who has a proven track record within Australia as well as balance sheet strength.



### 3. Introduction Response

#### [Consultation Paper Introduction: pages 2 - 4]

##### 3.1 Changes in response to recent experiences

**Consideration of State Liquidated Damages** – it is difficult to see how this would represent VFM to the State. Contractors will form a view on the likelihood of delay to the project and price in a component of Liquidate Damages (LDs) that may never become payable. Additionally, the daily rate of LDs payable by a builder to the project financiers will already be significant to cover the cost of debt repayment, equity return and Special Purpose Vehicle (SPV) management costs. If a builder is unable to continue construction due to financial difficulty, it is unlikely they will be able to fund financier or State LDs.

However, in some circumstances it may be appropriate to quantify the damages the State may incur if a project is late, rather than the private sector trying to price uncertain costs. In such cases, the private sector would also seek to limit the amount of damages payable to the State and this should be considered by the State and built into the contract documentation to avoid protracted discussions within the bidding consortium and to expedite contract close with the State.

**Evaluation of financial strength** – this should be a key evaluation criteria to ensure the building contractor has the capabilities and financial capacity to deliver the project.

**Constructor performance issues** – it is unclear what the State is proposing in relation to greater capacity to liaise with project financiers. If the financial strength of the constructor is demonstrable, then the constructor should be left to manage the performance of the project, including subcontractors. However where a subcontractor payment is not in dispute, it should be acceptable for the State to make payments where the constructor fails to do so.

Careful consideration should be given to the inclusion of any form of look forward test in the project documentation. Constructors (with demonstrated financial strength) have sufficient incentive via payment of LDs and outstanding bank guarantees to achieve completion. Constructors also have the ability to accelerate and should be left to manage program.

**More active State side contract management** – caution should also be exercised in this area. Additional stakeholder requirements only mean increased contract administration and potential for delays, particularly in the design review process.

The role of the Independent Verifier (IV) on PPP projects also requires re-examination. It is appropriate for the constructor to also be a party to the appointment of the IV since the decisions of the IV directly impact on payment and completion. The refusal of States to allow constructors to be a party to this appointment has only led to increased contractual complexity and cost to projects through the separate role of the IV as a 'Sub-IV', which will still give the constructor direct contractual rights in relation to the IV/Sub-IVs performance. Many overseas participants (financiers/contractors) do not understand the need for such arrangements. Ultimately the State should be comfortable that the IV is obliged to act independently and has adequate insurances if it fails to perform its professional obligations.

## 4. Changing the value for money assessment [Consultation Paper section 1: pages 5 - 9]

### 4.1 Options for discussion

The Committee generally agrees with the listed criticisms of the operation of the Public Sector Comparator (PSC). Typically, insufficient details are provided on the composition of the PSC calculation and underlying assumptions. We also agree with comments in relation to:

- Importance of risk estimates in PSC development;
- Requirement to progress the reference project to a greater level of design to facilitate better cost and risk estimates;
- Testing the PSC for constructability; and,
- Benchmarking.

The PSC is a critical tool in the development of PPP projects. The Committee supports retaining the PSC for budgeting and scoping purposes and considers that additional focus should be made on ensuring it is developed effectively. Areas where the government should consider focusing additional attention include:

- Benchmarking: Increased focus on benchmarking (of outturn costs) against other projects of similar scale and scope to improve the reliability of the PSC. This should be conducted internally and via peer review for larger projects; and,
- Timing of budget commitment: There is anecdotal evidence that the PSC is set too early in the project planning life-cycle and this creates significant budget and affordability hurdles as scope is developed, but budgets do not keep pace. Additional effort should be placed on providing more robust cost estimates at the business case phase and/or presenting costs as a 'range' of outcomes.

The Committee supports the development of a program level VFM test for PPP projects (pre-procurement). In particular projects which are considered to be well suited (or best suited) to PPP delivery should be selected at the program level – for example, it is likely to be possible to demonstrate empirically and qualitatively whether schools and hospitals delivered as PPPs are delivering VFM based on existing projects. Projects that are suited to PPP would then proceed on that basis unless there was compelling evidence against that means of delivery.

Better information, both quantitative and qualitative, should be gathered to demonstrate the relative merits and risks of PPPs. Recent projects such as the Victorian Desalination project and Ararat Prison provide some evidence for the effectiveness (or otherwise) of risk transfer from the State's perspective. Other benefits, such as building quality, facility availability and reliability and performance should also be considered in the assessment of the benefits of the PPP model and taken into the assessment of whether the model is likely to offer VFM. In our experience the qualitative benefits of PPPs are considerably understated – in particular:

- Risk management and transfer – reductions in management time in dealing with risk;
- Improvements in operational effectiveness;
- Reductions in management time associated with facilities management and maintenance;

- Reduction in the impact of back-log maintenance; and,
- Improvements in building efficiency (including energy and environmental efficiency).

It is unlikely that the affordability threshold approach will be of significant benefit in terms of procurement efficiency without being accompanied by improvements in the rigor of the cost estimation (see earlier comments on benchmarking). However, in combination with a sufficiently robust cost threshold the scope ladder is likely to be advantageous in reducing the risk of delays in procurement by reducing the risk of multiple phases of bidding – though this will require absolute clarity on the State’s preferences which would require more emphasis on establishing evaluation criteria.

#### 4.2 Specific areas for feedback

- a) *Will the reforms improve or maintain competitive pressures and improve the efficiency of the bidding process?*

Yes, the reforms should improve the efficiency of the bidding process and could improve competitive pressures.

- b) *To what extent will introducing the scope ladder and affordability benchmark improve the quality of tender responses?*

The introduction of the scope ladder and affordability benchmark should improve the quality of tender responses by focusing innovation to the areas of most importance to the State / end users.

- c) *Are there particular aspects of the State benchmark that would give greater clarity on scope requirements and therefore warrant greater disclosure?*

Greater disclosure on whole of life benchmarking would be good.

- d) *Should the scope ladder be fixed by government prior to tender release or should it be open to bidder feedback and be a bid item?*

The scope ladder should be fixed prior to bid submission, but could be part of an interactive tender process early in the procurement process.

- e) *How can we improve our qualitative evaluation criteria and assessment for PPP projects?*

Ranking the importance of the qualitative evaluation criteria would assist bidders in directing resources to the areas of most importance.

## 5. Expanding service delivery in PPPs [Consultation Paper section 3: pages 16 - 17]

### 5.1 Options for discussion

There is scope for the inclusion of additional services in PPP projects but caution should be exercised in determining where additional services are appropriate. In general terms there should be a natural alignment between the infrastructure and the services such that the benefits of combination of services outweigh the benefits of segregation of services. For example, in the new prison at Ravenhall the consolidation of custodial services and infrastructure is a good fit in that infrastructure solutions are instrumental in the way in which services are provided.

Similarly the health sector has a strong track record of delivering broader forms of PPP, including clinical services. The recent project at Midland in WA is an example of this type of bundling, though the concept is not new.

Furthermore, as well as combining services, other forms of bundling and service provision should be considered. For example, co-location projects have been used to enhance the public infrastructure as well as reducing capital outlay through the sharing of various services, for example shared plant or hotel type services in a health project. Private co-location is also used to reduce pressure on public services either through transfer or substitution, again in a health context.

We note that from the UK review of PPP projects, there is a move away from greater consolidation of bundled infrastructure and services. We do not make a similar recommendation at this stage, but suggest that each project and decision is tackled on its own merits. In some cases, where operational flexibility is paramount and/or there is limited relationship between infrastructure and the services, then separate procurement of the services elements may be desirable to maintain flexibility and VFM. Furthermore, account needs to be made of the impact on the competitive environment – bundling services for which there is limited capability in the market might reduce the overall level of competition for a project.

In our view there are opportunities to further develop the PPP model to deal with broader outsourcing. For example, in the prisons sector custodial services within existing prisons could be outsourced – the UK government is going through a process of this nature. The UK government has a policy of ‘do more for less’ and this type of services only PPP is expected to lead to significant operational savings. This is an area the Better Services Implementation taskforce may wish to consider.

## 6. Streamlining procurement process and bid costs [Consultation Paper section 4: pages 18 - 22]

### 6.1 Specific areas for feedback

- a) *Is there bid material that could be provided in less detail at bid stage?*

Yes, there is bid material that could be provided in less detail at bid stage. The examples of deferred documents for the Bendigo bid are a good start. The State should only be shortlisting consortiums / constructors who have demonstrated their ability to provide this type of information.

- b) *Is there any bid material that you consider could be provided at preferred bidder stage or following contract close?*

As above - certain project plans could be provided following contractual close.

- c) *Design costs are a significant bid cost item. Are there any changes that could be made to the State's requirements in the RFP that would have an impact on bid design costs?*

More design development by the State would reduce design bid costs - bid costs vary widely according to the complexity of the project requirements and the level of ambiguity which is tolerated within the contestable process. In Social Infrastructure projects the State's brief and indicative design have required extensive user consultations and highly detailed design submissions. Design costs during bidding could be significantly reduced through the use of a single State-supplied design for bidding purpose with limited consultation. Once selected, the preferred bidder could then invest in developing/altering the mandated design prior to Contract close.

- d) *Are there innovations in the electronic presentation of tender or bid documents that could be used more readily?*

Platforms such as Affinitext, Aconex or similar, could be used to provide State material.

- e) *Are there any processes or innovations used in other states or overseas on PPPs or other forms of procurement which Victoria should consider adopting?*

Overseas features of PPP models for consideration (1) greater upfront design development; (2) separate financing tender once a preferred design & constructor has been chosen.

- f) *Does the probity process unnecessarily inhibit innovation and achieving optimal commercial outcomes? How might this process be improved?*

Probity procedures can inhibit innovation and communication. If State representation is active and robust, there is no need for a constantly present probity auditor and/or elaborate recording procedures. This aspect was very well handled on the recent Royal Children's Hospital project.

**Bid cost contribution**

- g) What is considered an appropriate amount without interfering with current bid dynamics?*

This will depend upon the individual project but as a guide 1-2% of project budget, say \$5-10m per bidder on a \$500m project. Recognising that this is a substantial sum, it will encourage careful bidder selection and a consistently strong market response.

- h) Should the contribution be set up front?*

It is important that the sum be set and disclosed up front. The fee would only apply to the 2-3 shortlisted bidders. If the bid cost contribution was set up-front, then the recovery of such costs will not be included in the overall tender pricing.

- i) Do all bidders or just unsuccessful bidders receive a bid contribution?*

All bidders.

- j) What is an effective and efficient way for the State and the winning bidder to acquire intellectual property in losing bids?*

If the State and the winning bidder wish to acquire intellectual property (IP) in losing bids, they should have to pay for it. Bidders should be asked to put a price on their IP as part of the bid submission. The acceptance of that fee would constitute payment for a license to use the intellectual property contained in the bid. The value of the IP is substantial and forms part of the payments by Government.

## 7. Developing a streamlined PPP model [Consultation Paper section 5: pages 23 - 24]

A key issue with PPP and complex procurement models is the cost of implementing them. Tender costs are high and where private finance is involved, finance is relatively expensive. There is a large fixed cost involved in delivery of complex PPP procurement.

A scaled down, or simplified, version of the PPP model could have the benefit of reducing project development costs to a level which supports a PPP delivery. The 'PPP Lite' model would simplify the PPP process and PPP contracts; such as the performance requirements; to make them easier to tender. This would be expected to create a process with lower tender costs. The intention would also be for the model to be replicated across a number of projects to drive efficiency.

It is our view that the necessary procurement efficiency could be best achieved by identifying programs of projects around which consistent procurement and contract documentation can be built, and around which the market can build procurement and delivery expertise. Relatively simple asset categories would be well suited to this model of delivery:

- Bundled schools projects;
- Social housing;
- Community and smaller scale health projects; and,
- Government accommodation – police stations; etc.

A key element of driving procurement efficiency would be identifying sectors where there is likely to be repeated procurement of similar assets over time; hence the selection of the above asset classes. A key common theme in the above asset classes is the relatively 'standard form' for both design and functionality – which would foster consistent development of output specifications and KPIs.

The UK Government has recently launched an initiative to develop standard schools designs to integrate best practice and improve procurement outcomes by allowing the construction industry to build skills and capacity around a simplified process. These projects will be delivered as PPPs.

A question may be asked around whether procurement of relatively 'standardised' assets could drive VFM through a PPP procurement and the case would need to be tested for each asset class (at the program level and as recommended elsewhere in this response). However, we believe that the VFM case is likely to remain strong around 'whole of life' costing; asset utilisation; and risk transfer and management.

In other jurisdictions, in particular the UK, standardised documentation, such as standard contracts and payment regimes, has been achieved in certain sectors. The asset classes listed above lend themselves to the development of standard documentation. We also point to the Eastern Goldfields prisons project in WA which has used simplified KPIs as a guide to contract simplification.

We recommend that the State develops a 'PPP-Lite' pathfinder project in either social housing or schools to develop and test the model. This is likely to involve some cost in the development of the first project (such as revised commercial principles). Subsequent projects would be expected to benefit from simplification and the developing capability of the market.

Furthermore, taking a slightly different perspective, the Government’s standard leasing documentation could be incrementally amended for certain types of project to give a ‘lease plus’ approach which delivered more of the benefits of PPPs through a well understood delivery model. This could include enhancements around integrated services (soft facilities management); payment mechanism and incentives; whole of life approach; and asset utilization; etc. to provide some of the benefits of PPP within a leasing structure. The types of project to which a ‘lease plus’ approach could apply includes more complex accommodation – such as police facilities (NSW developed a police headquarters project on a similar basis).

### 7.1 Overview

The following comments are from a Tier One Contractor with extensive PPP experience.

Contractors responded to Australian governments’ desire to create a market place in the late 1990’s to move from the sparsely used Build, Own Operate Transfer (BOOT) and Bulid Own Operate (BOO) models into the PPP model to deliver major infrastructure projects that were growing in value and complexity to cope with the infrastructure needs around Australia.

Governments aim was to transfer risk, financing and long term facilities/operational management to the private sector, to gain whole of life innovation, productivity and cost efficiency.

The private sector responded to this call to create a competitive market place by building in-house skills across all levels of the PPP model - finance, contract, design and construction and long term (>25 year) facilities operational maintenance. Subsequently, these in-house capabilities and skills have become a perquisite to provide surety for government and Project Co. debt and equity to the commitment to use PPP’s to deliver what was expected to be at least 15% of the ongoing infrastructure spend.

### 7.2 Commitment

Tier One Contractor’s commitment to responding to the PPP delivery model remains, and although issues relating to the cost of tendering and complexity of contracts need constant development, the key element is actually the planned pipeline of projects across Australia for competing qualified companies to be able to commit resources to.

The boards of corporations responsible for Tier One contractors operating in the PPP market have three primary questions:

- Do we have the commitment & capability to sustainably deliver the scope of works?
- Can we assess and accept the risk?
- Who is paying?

**Further reference:** Infrastructure Partnerships Australia, *Financing Infrastructure in the Global Financial Crisis (2009)*; and, *Performance of PPPs and Traditional Procurement in Australia (2007)*



### **7.3 Context for change**

There is ample evidence to demonstrate PPP models or derivations are suitable for government to viably procure projects across numerous asset classes with a capex down to \$50m, for example KPMG for Victorian Department of Human Services, *Social Housing: A Discussion Paper on the Options to Improve the Supply of Social Housing (2012)*.

The PPP model has an intrinsic guarantee. Project Co. must have partners that will provide surety of delivery to the client (Government & related parties) and to the Project Co. debt and equity financial partners - it would appear the Ararat Prison PPP did not pass this fundamental test.

Provided this guarantee is fulfilled in the Project Co. consortium, then primarily, it is only then the “will” of the client (government and key stakeholders) to adopt a financial contracting model that will meet the needs of the parties.

As in the report noted above, there are seven finance/contract models, all of which, if supported by a client (Government & related interests) and Project Co. team, only need the “will” of these parties to make these models work.

### **7.4 Options for discussion**

The PPP model can be applied to potentially any sector of infrastructure whether it be social housing, local government through bundling projects such as bridge maintenance, local council services, universities, road systems maintenance or schools, as was done successfully with the 12 Partnerships Victoria in Schools (PViS) program in the growth suburbs of Melbourne.

The NSW Government report into local Government using PPP as a delivery model to aggregate services to deliver efficiency, productivity gains and get certainty into infrastructure upgrade and maintenance did not reach maturity (Working with Government: Guidelines for Privately Financed Projects NSW Government – December 2006; NSW Technical Paper: Discount Rates for the Evaluation of Private Financing Proposals - February 2007 and Risk Allocation and Commercial Principles NSW Government - May 2007).

It could be argued this was due to the lack of:

1. Bureaucracy to package the reforms for private industry to respond to;
2. ‘Will’ of the parties to make the model work.

Again a planned market place for this delivery model will drive value for the public purse.

### **7.5 Rational and precedents**

Many of the Tier One contracting companies that operate in Victoria and Australia have either direct or related experience in the UK, Canada, USA and other countries that utilise the PPP/PFI delivery model and would welcome governments in Australia building this market to maturity to drive outcomes for all stakeholders.

## 7.6 Impacts and risks

Tier One contractors by their nature are adaptable and innovative, and it is clear, following the GFC and with ongoing uncertain financial conditions that unless we as organisations are prepared to explore and commit to new ways of doing business with governments and the community then we will not fulfill our obligations to our shareholders.

As noted in item 7.4 above there have been numerous reports done in Victoria, Australia and around the world that together we can deliver infrastructure in any form that the stakeholders can guarantee provided that the will and commitment is there to properly assess, allocate deal with the risk.

## 7.7 Specific areas for feedback:

- a) *What are the critical aspects of a traditional PPP procurement approach that need to be simplified under a streamlined approach?*

Use the Partnerships Victoria PPP procurement model as the basis to maximise interactions with a highly informed government procurement team, to minimise legal cost, reduce to 2 bidding consortia at end of EOI and eliminate BAFO.

- i. *What design requirements may be streamlined under a revised model?*

Have simplified clarity around the output specification to maximise innovation and efficiency of the private sector. This means the client (government & related parties) must complete their due diligence thoroughly and include a trusted adviser throughout all levels of the pre-procurement process.

- ii. *How could the procurement process more broadly be streamlined under a revised model?*

Examples of this are well documented in many Victorian, Australian and internal studies and reports. The tier one contracting corporations will engage to meet the governments needs on the basis of achieving sustainable outcomes for all stakeholders, all that is required is the "will".

- b) *What are the key sectors that a streamlined model could apply?*

There are potentially no barriers - refer comments above.

- c) *What is the level of market appetite for a streamlined model?*

If there was a committed long term market place then contractors would commit resources to servicing that streamlined model marketplace.

## Case Application: Social and Technical Infrastructure Projects (approx. \$50m capex)

### **PPP model using a Design and Construction Turnkey Contracts**

*The Fixed Price Contract is dramatically different to a true "turnkey" contract. (The word "turnkey" is often used interchangeably with "fixed price contract", or what are in fact fixed price contracts are wrongly called "turnkey" contracts on particular projects, thereby giving rise to the confusion.)*

*A turnkey contract is one in which the Principal and the Contractor agree on a fixed Contract Sum to be paid upon completion of the works to a particular standard and/or performance criteria, and in relation to which the Principal does not participate in any way in the actual performance of the works but, at the end of the works, is invited to inspect the works and, subject to the works being adequately constructed and performing to the requisite criteria, the Principal then paying the full amount of the Contract Sum and taking over the works. (The Principal is said to simply hand over the cheque, turn the key and commence operation.)*

*In a fixed price contract, by comparison, the Contract Sum is adjusted throughout the contract period, (for the reasons set out above).*

*A true turnkey contract, therefore, is more akin to a purchase contract than to a construction contract.*

### **Funding the Turnkey - Fundamentals**

*The D&C/FM contractor will not enter into development/process risk*

*A Turnkey arrangement requires a 100% Guarantee from the Client to ensure payment of its Contractual Contract Sum.*

*A Turnkey by its nature assumes that the Client has chosen to use an alternative funding source rather than using its own internal funding. The Client reasons for using this model need to be understood fully in assisting to facilitate an alternative funder for the Turnkey.*

*It is normal for the Third Party Funding entity to require a tripartite which the D&C/FM will be a party to and affords both the Funder and D&C various step in rights and other rights on the Client Default.*

### **Guarantees from the Client/Project Co. compliance requirements**

*It is not unusual for the Funder to leverage off the D&C/FM Contractors balance sheet when the Client has a shortfall. It is important to understand this and inform Parent for approvals and then allow Risk and Reward accordingly.*

*The benefit of the Funder having a Tier one D&C involved is that they can assume in their Risk modeling that the TODC will complete the Project regardless of the circumstances and especially the default of the Client. This is apart from the TODC having deep pockets to absorb any related cost issues such as insurance, delays etc. including IR and unforeseen events.*

***A typical Model might have the following form***

*Funding will be provided by the lender to secure the contractors contract and cash flow payments with a client funded bank guarantee for the value which is returned/cancelled when the Project has been completed in accordance with the Contract by the D&C/FM Contractor.*

*Above the line the Contractor can choose to commit a sum (normally profit margin) to a deferred payment when the project is completed and the funder paid out, and then receive this final payment plus interest.*

*This is normally used when the Client can not raise sufficient funds at project inception under the funders LVR model, but has the funds available on completion and settlement.*

***Benefits can include:***

- *Contract conditions with no litigation, LD's each wears own concept;*
- *Strict Modification Regime "no variations unless authorised and \$ approved prior to proceeding" with cap by Funder;*
- *Positive working relationship;*
- *No interference minimum paperwork comply and get on with it;*
- *Strict security of payment conditions guaranteeing payment; and,*
- *Independent Certifier Jointly appointed by Client, Funder, D&C so genuine Honesty and Fairness clauses are included in Contracts and appointment contract with IC.*

***Aims:***

- *Diminish the threat of disputes through a more co-operative approach between principals and contractors;*
  - *Risks resides with entity most able to influence its outcome;*
  - *Lower liability exposures and a greater ability to pass through cost increases and delay risks; and,*
  - *Design process should be more innovative and co-operative when unconstrained by liability apportionment issues.*
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