Mayoral Position Paper on Public Private Partnerships

November 2013

EY Building a better working world

Contents

Glossary of terms

BaFO	Best and Final Offer
BBC	Better Business Case
BOOT	Build, Own, Operate and Transfer
BSF	Building Schools for the Future (UK)
CCO	Council Controlled Organisation
CMDHB	Counties Manukau District Health Board
DBFM	Design, Build, Finance and Maintain
DBFO	Design, Build, Finance and Operate
DBM (+O)	Design, Build, Maintain (and Operate)
ECI	Early Contractor Involvement
GFC	Global Financial Crisis
JV	Joint Venture
LIFT	Local Improvement Finance Trust (UK)
LTP	Auckland Council's Long Term Plan
NAO	National Audit Office (UK)
NHS	National Health System (UK)
NIU	National Infrastructure Unit
NZTA	New Zealand Transport Agency
PFI	Private Finance Initiative (UK)
PPP	Public Private Partnership
PSC	Public Sector Comparator
SPC	Special Purpose Company
VfM	Value for Money

Introduction

Introduction

The Mayor has asked for a position paper to be developed on the nature and uses of Public Private Partnerships (PPPs). This paper is to focus on the range of PPP options that may be suitable for major Council and CCO projects.

Auckland Council has historically procured major capital expenditure projects using traditional procurement approaches centred on construction based models, with elements of risk transfer to the private sector in terms of design and construction but generally with no ongoing obligations in terms of asset maintenance and operation. However, such traditional delivery models have limitations which may not enable the Council to achieve the best value for money and project outcomes in all circumstances. For large, complex or innovative projects, better value and project outcomes may be achieved by utilising non-traditional delivery models.

The New Zealand Government is now actively pursuing non-traditional procurement options, and specifically PPP approaches involving greater private sector involvement in the provision of both infrastructure and services, where these can demonstrate greater value for money to the public sector.

For some local Governments, the absence of projects of sufficient scale means that transaction costs can be a significant barrier to the implementation of alternative procurement models. However, the amalgamation of the eight former, separate councils has provided Auckland Council with increased scale providing more opportunity to consider PPPs. In addition, the Government has recently increased the period of concessions local Councils can offer for transport projects, thereby making transport PPPs more viable.

PPP models are characterised by joint working and risk sharing between the public and private sectors and are aimed at delivering better outcomes (as opposed necessarily to saving money). PPPs can include relatively simple outsourcing-type partnerships where services are provided on short or medium-term contracts, or longer-run private finance partnerships such as the Design, Build, Finance and Operate (DBFO) model. Internationally, well-formed partnerships with the private sector in the right circumstances have delivered clear benefits: in driving forward efficiencies; getting projects built to time and to budget; and in creating the correct disciplines and incentives on the private sector to manage risk effectively. There is a wide pool of experience of these projects globally, many successful but some not so. Auckland (and New Zealand) is in a position to learn from the successes and mistakes of other jurisdictions.

In order to assist Auckland Council in assessing the suitability of PPP approaches to Council projects, this paper covers the following:

- The characteristics of a PPP and an outline of the range of PPP procurement approaches available
- An overview of the current PPP market in New Zealand and internationally
- Auckland Council's policy with respect to PPP and consideration of whether PPP procurement approaches could be successfully applied at a local Government level to Council infrastructure projects
- A description of some of the key structural aspects and risk allocation principles of a PPP
- An outline of any value for money and affordability considerations
- An overview of procurement timescales, project management, governance and approval considerations

While PPP approaches involve greater private sector involvement in the delivery of public infrastructure, these approaches are distinct from Privatisation. Privatisation involves the transfer of asset ownership to the private sector through the transfer of a public sector run enterprise to one that is privately owned and operated, with the market and price mechanism defining the service provided. The argument for privatization is based on the view that privately run enterprises, such as utility companies, airlines, and telecommunications systems, are more efficient and provide better service than companies run by the public sector. However, privatization is often seen as a way for the public sector to raise cash and to reduce its role as service provider through the sale of Government assets.

While PPP approaches seek to take advantage of private sector experience and expertise, a key difference to privatisation (and a key lesson learnt in early PPPs, especially in the UK) is that in most PPP models, asset ownership is retained by the public sector. With PPPs, the public sector defines what is required to meet public needs and remains the client throughout the contract, enabling the public sector to harness the private sector to deliver investment in better quality public services while maintaining frontline services in the public sector. PPPs are not a “one size fits all” solution and experience suggests that as one tool in the toolbox they will provide excellent value and outcomes in some circumstances and sectors while being totally unsuited to others.

PPP procurement models

1. PPP procurement models

1.1. Introduction

Traditional procurement models have historically been favoured by the public sector, owing to the existence of precedents for such models, and the familiarity of suppliers and contractors with such forms of project delivery.

Traditional models tend to be limited to the design and construction of an asset, and generally do not contemplate any post-construction maintenance and operation activities. For large, complex or innovative projects, better value and project outcomes may be achieved by utilising a non-traditional procurement model. Alternative delivery models can enable the public sector to take advantage of the experience and expertise of the private sector. These alternative models do not have a common set of features. Some apply to the design and construction period of a project and some extend to the post-construction operation or maintenance of the asset. Some are financed by the public sector and some are financed (partly or wholly) by the private sector.

The main argument for private sector involvement in infrastructure delivery and operation is that significant efficiencies can be driven by the profit motive, integration of whole of life responsibility and exposure to competition. The private sector can:

- Identify and manage risks and costs
- Provide specialist management and technical skills
- Manage whole of life risks from design responsibility through to hand back to Government
- Coordinate capital costs with whole-of-life operating costs
- Improve the efficiency and quality of services
- Assess market needs and capacity
- Raise financing

A UK study in 2000 found that private sector involvement in competitive local government infrastructure delivery can lead to savings of 17%.[1] This figure is net of the higher financing costs borne by the private sector, meaning that the raw operational savings may be even higher. The benefits of partnership models in Australia have been set out in studies by Partnerships Victoria in 2004 and Infrastructure Partnerships Australia in 2009, amongst others.[2]

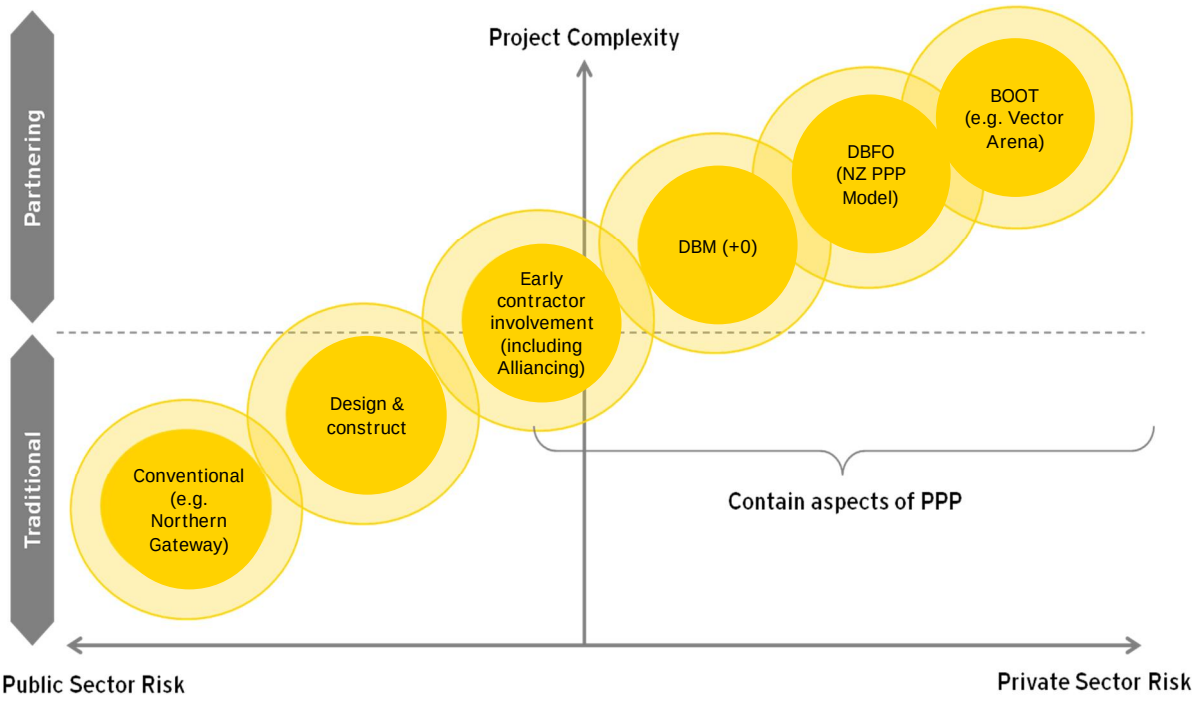
While the cost of private finance may be more expensive than the cost of public sector borrowing, in the right circumstances, the other benefits of a PPP solution can outweigh these additional costs. This aligns with the focus of the New Zealand Government which is on value for money and improved outcomes.

1.2. Procurement approaches and PPP

The broad range of procurement approaches that could be applied to deliver an infrastructure project ranging from traditional procurement through to fully outsourced solutions, are shown in the diagram below.

These potential delivery approaches can be broken down into a broader range of procurement options that incorporate combinations of risk transfer for the design, build, maintenance, operation and financing of an asset.

[1] Arthur Andersen, Value for Money Drivers in the Private Finance Initiative, January 2000
[2] Growth Solutions Group, Review of Partnerships Victoria Provided Infrastructure: Final Report to the Treasurer, January 2004, and Infrastructure Partnerships Australia, Financing Infrastructure in the Global Financial Crisis, March 2009



Key

DBM (+O): Design, build, maintain (and operate)

DBFO: Design, build, finance and operate

BOOT: Build, own, operate and transfer

As debated above, PPP models are characterised by a greater degree of both partnering and risk transfer than more traditional approaches to procurement, and involve greater private sector involvement in the delivery of an asset and/or its operation over the medium to long term. These models include relatively simple outsourcing-type partnerships – where services are provided on short or medium-term contracts without any capital investment – or longer-run private finance partnerships such as the Design, Build, Finance and Operate (DBFO) model (refer Appendix A).

New Zealand has been involved in PPPs in some form for a number of years without necessarily using this umbrella terminology. The recent push towards alternative procurement, and the two high profile PPPs to date (Hobsonville Schools PPP and Wiri Prison PPP), have involved variations of the DBFO model. Under this approach, the public sector enters into a fixed price long term contract with the private sector for the design, construction, maintenance and operation of an asset, with the assets reverting to the public sector at the end of the contract term. However, PPPs internationally encompass a wide variety of procurement approaches involving the public and private sectors working together in some way, many of which are already present in New Zealand (for example, the Vector Arena, which represents a Build, Own, Operate and Transfer (BOOT) scheme – see section 1.5.2).

This section presents an overview of some of the PPP procurement approaches which may be appropriate for local Government projects and covers only on those approaches that involve capital expenditure which is the focus of this paper. However, the outsourcing of services alone over the short to medium term (such as the five year joint contract that Central North Island Health Boards have with the Spotless Group), can also be viewed as a type of PPP.

Procurement models of a PPP nature involving capital expenditure which may be appropriate for the local Government sector can generally be divided into three categories:

i. Collaborative construction based models

ii. Long term service contracts, typically with a whole of life approach to asset management, where Government pays the private sector to deliver infrastructure and related services over the long term

iii. Long term partnering models

These categories include a wide range of approaches that could be applied to delivering Auckland Council infrastructure. A summary of these approaches is provided below, together with their key advantages and disadvantages, and circumstances where they may be suitable. Some of the key models under each of these categories are described in more detail in Appendix A. Appendix A by no means covers all of the PPP procurement models available – each model can be adapted to the specific needs of an individual project or program.

Determining the most appropriate procurement method is a key element to successful project delivery. It is important to consider which form of procurement will achieve Council's wider objectives while optimising value for money. Issues such as specification of outcomes and outputs, risk allocation, whole of life costing, price certainty, procurement timelines and market appetite will impact the procurement decision.

1.2.1. Collaborative construction based models

Collaborative construction based models (including Early Contractor Involvement (ECI), Managing Contractor and Alliancing) tend to be limited to the design and construction of an asset, and normally do not involve significant ongoing maintenance and operation activities. The successful party would complete construction works consistent with the design brief, with the public sector providing the funding for the project, and assuming responsibility for the operation of the facility and delivery of services thereafter. These procurement models have many of the same characteristics of traditional procurement models in that:

i. The majority of risks are retained by the public sector

ii. Funding is provided by the public sector

iii. Ongoing operations and maintenance responsibilities are contracted for separately

Advantages and disadvantages of collaborative construction based models

Collaborative construction based models have a number of potential advantages over traditional procurement models, including:

- A team approach with private sector expertise and experience harnessed early
- Increased opportunity for innovation
- Better integration of construction methods and fewer variations during construction

Circumstances where collaborative construction based models are suitable

Collaborative construction based models can be suited to situations where a shorter delivery time is critical or where large unquantifiable risks exist that a contractor would be unable or unwilling to price (for example, Christchurch rebuild horizontal infrastructure and the London Olympics). However, the key disadvantage of these approaches is that price risk is not transferred to the private sector.

A recent National Audit Office (NAO) post games review on the London Olympics finds that, at this stage, the anticipated final cost of the games would leave a £0.4 billion under spend on the £9.3 billion Public Sector Funding Package agreed in 2007, if that were to be the final position[3]. However, it should be noted that the 2007 £9.3 billion budget included a contingency of £2.7 billion.

The key decision for Auckland Council to make for individual projects or programmes is whether speed / uncertainty outweigh the risk transfer benefits of long term service models.

Examples of collaborative construction based models in practice

Alliancing has been used successfully by NZTA to deliver roads projects with a capital value of over $400 million to $500 million for a number of years. An example of this is the $1.4 billion Waterview project currently under

[3] National Audit Office, The London 2012 Olympic Games an Paralympic Games: post-Games review, December 2012.

construction. However, the latest large roads project, Transmission Gully, is being procured under a Design, Build, Finance and Operate (DBFO) PPP contract (see Section 1.5 below)

1.2.2. Long term service contracts

These approaches, including Design, Build, Operate and Maintain (DBOM), Design, Build, Finance and Operate (DBFO) and Joint Ventures (JV's), typically involve a service contract between the public and private sectors where the public sector pays the private sector to deliver infrastructure and related services over the longer term and are aimed at providing better value for money to the public sector through the transfer of appropriate risks to the private sector, a clear focus on the whole of life costs of projects and an innovative approach to service delivery.

A key difference to traditional or collaborative construction based models is that the public sector specifies their requirements in terms of outputs. Under a traditional / collaborative construction based model, Council would typically provide the private sector with a series of specifications and designs and require construction of the facility based on the detailed design. Under long terms service contracts, Council would specify its requirements in terms of outputs which set out the required services, but do not specify how those outputs are to be provided. This allows the private sector to provide innovative and cost effective solutions. Typically the scope would require the private sector to form consortia to deliver the services, hence providing an integration of parties that may assist innovation by challenging the received wisdom of individual disciplines (for example, increased operator input into design).

The key characteristics of these models and how these compare to traditional procurement (and collaborative construction based) approaches are detailed below.

Table 1 : Comparison of long term service contracts vs. traditional procurement

Characteristic	Traditional procurement	Long term service contract
Scope of services	Requirements specified on an input basis	Requirements specified in the form of output or outcome service requirements to maximise private sector innovation
Length of contract	Usually short term construction only (or design and construction) contracts	Long term, typically 25 to 30 years (subject to type of services)
Risk allocation	The majority of risks are retained by the public sector	Detailed and defined risk allocation, with risks allocated to the party best able to manage them (see "standard" risk allocation matrix at Section 4.3)
Whole of life costing	Contractor has no ongoing maintenance or service obligations during operations	The private sector is responsible for the maintenance and / or operation of the assets for the whole or the concession period, thereby transferring of whole of life cost risk
Price	Empirical evidence of cost (and time) overruns	Whole of life price certainty
Payment profile	The procuring authority pays for the costs of construction, maintenance and services as they arise	All costs are included in a "unitary" payment which is fixed over the life of the contract and is not payable until construction is complete and services have commenced to an agreed standard
Performance measures	Payments are not generally linked to performance	Payments are linked to performance with no payment to the contractor until services are provided. Payments are based on asset availability and service delivery against a range of performance indicators
Funding	The initial capital costs of construction are paid for by the public sector upfront	The initial capital costs of construction are financed by the private sector, and amortised over the concession period

Advantages and disadvantages of long term service contract models

The key benefits and disadvantages of long term service models approaches compared to traditional and collaborative construction based approaches are outlined in the table below.

One of the major benefits of long term service contracts is that responsibility for operations and maintenance is allocated to the same party responsible for design and construction. Combining responsibility (and risk) for all of these aspects, and transferring whole of life cost risk to one party, incentivises quality design and construction.

Table 2 : Benefits and disadvantages of long term service models vs traditional / collaborative construction based approaches

Advantages	Disadvantages
► Greater budgetary certainty - the total contract value is known before construction commences ► Requirements are specified in the form of an output specification, providing wider opportunity to develop innovative solutions ► The transfer of design and construction risk incentivises completion on time and to budget (see below) ► The contractor is incentivised to maintain the assets to a high standard throughout their life due to the long term nature of contractual commitments. The transfer of whole of life cost risk encourages an efficient design which maximises operational benefits and quality construction ► Significant risk transfer incentivises the private sector to manage risks effectively. In 2009, the NAO reported that the use of private finance can deliver real risk transfer with a good contract[4]. Risk transfer has proved successful as the public sector has been protected when projects have gone wrong (see Case Study 1) ► The payment stream allows deductions to be made if the project does not meet the contractual requirements. This incentivises performance and means that the public sector only pays for services it receives ► The competitive tender process encourages operational efficiencies. The length and size of a project can encourage new entrants thereby increasing competition ► Greater access to private sector experience and expertise. The coming together of private sector parties creates opportunities to challenge the norm and innovate ► The introduction of external financiers brings added rigour to the procurement process. Lender due diligence and monitoring of project risks increases the confidence of investors and the public sector in project deliverability ► Enforces good project disciplines in the public sector, for example, clear definition and prioritisation of project objectives and strong sponsorship ► Application of better procurement disciplines typically leads to improved procurement skills in the client entity which then transfer to other projects	► A more intensive, lengthy and costly tendering process. ► Relies on well defined functional and service specifications. Whilst this is often considered an advantage in the case of very complex projects with a large number of diverse stakeholders, it can be a challenge to achieve ► Can be inflexible if needs change over the contract life with potentially higher cost variations due to reduced contract flexibility. In 2008, the National audit Office (NAO) concluded that changes to operational PFI PPP projects are often poor value for money[5] (See Case Study 2) ► Private finance is raised at a higher cost than Government can borrow, and so a value for money judgement is required for all privately financed projects, to confirm that the additional costs of private finance are more than offset by the benefits of risk transfer and private sector delivery

The advantages of the Design Build Finance Obtain (DBFO) model has been recognised in the UK. The December 2012 HM Treasury report "A new approach to public private partnerships" states that elements of PPP have "offered benefits. These include the private sector's project management skills, innovation and risk management expertise, such as, ensuring buildings are delivered to a high quality, on time and budget and that assets are maintained to a high standard throughout their lives." However, this report also recognises a number of weaknesses with the approach (see Section 2.4.1).

[4] National Audit Office, *Private Finance Projects*, November 2009
[5] National Audit Office, Making changes in operational PFI projects, January 2008

Case study 1 : Equity bears real risk

In its 2012 report *Equity investment in privately financed projects*[6] the NAO highlighted a number of projects where equity losses have occurred. In 2004, the construction costs of several projects involving Jarvis companies exceeded those anticipated during the bidding process. Jarvis plc and other PFI investors bore the costs of filling the £120million funding gap in projects including Whittington Hospital, Tyne and Wear fire stations, Lancaster University and Wirral Schools.

Case study 2 : Lack of flexibility

In a 2008 report on *Making changes in operational PFI projects*[5], the NAO highlighted that under the Avon and Somerset courts project an extra 15 per cent was charged by the project company for a major change request. When the procuring authority challenged the project company on where the contract stated that a fee could be charged for a major change, the project company responded by arguing that the contract did not specify that it could not be charged.

Delivery to time and to price

The NAO's 2009 report, Private Finance Projects[4], highlighted that PFI contracts are fixed price and that they impose heavy financial costs on the project company if they do not deliver on time and this can incentivise the timely delivery of projects. In response to a survey undertaken by the NAO on projects between 2003 and 2008, it was found that 69 per cent of projects reported delivery to the contracted timetable and 65 per cent to contracted price.

This is supported by research by Infrastructure Partnerships Australia, as highlighted in the charts below:

Diagram 3 : Percentage cost overrun for both traditional & PPP procured projects

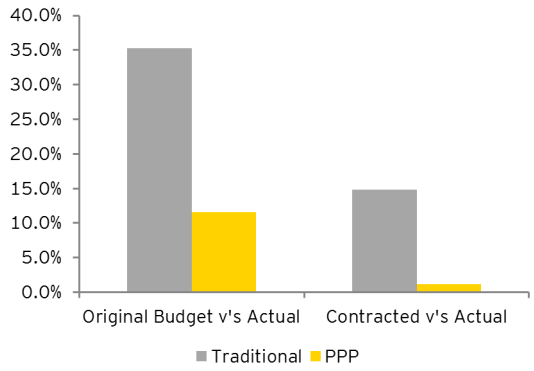


Diagram 4 : Percentage "value weighted" time late or (early)

Source: Infrastructure Partnerships Australia, Performance of PPPs and Traditional Procurement in Australia, 2007

The above charts indicate that both time and cost overruns were considerably greater under traditional procurement than under PPP both against predicted budgets and contracted prices, with PPPs (once contracted) delivered (essentially) on budget and early.

[6] National Audit Office, Equity Investment in Privately Financed Projects, February 2012

Circumstances where long term service contracts are suitable

DBFO / DBFM models are suited to projects where:

- The public sector is able to define their requirements in terms of an output or even outcome specification. If the public sector is unable to define their requirements in terms of outputs and/or outcomes and link these to performance measures, then it is unlikely that a DBFO / DBFM model is suitable for the project.
- The project is of sufficient scale and significant scope for value for money and innovation through the outsourcing of services. DBFO / DBFM models typically involve higher tendering costs for bidders. These additional procurement costs, which can be significant, need to be recouped in order for a project to provide a value for money solution. Under a DBFO / DBFM model, savings can be achieved through private sector efficiencies and innovation, however, if a project is not of sufficient scale, there is limited opportunity for efficiencies and innovation.
- There is the market capacity, capability and experience to deliver the services together with sufficient market appetite and competitive tension to ensure a value for money solution.
- Timeframes for delivery are not urgent (although achieving the operational start date may be crucial, for example, a new school term). DBFO / DBFM models typically involve longer procurement timeframes than for traditional procurements due to the additional work required by both the public and private sectors prior to contract award. If an asset is required urgently, these models may not be suitable.

However, DBFO / DBFM models are not typically suited to sectors and projects where there is insufficient long term certainty on the future requirements of services, or where fast-paced technological changes made it difficult to establish requirements for the long term.

JVs are usually established because the parties have complementary objectives and share a view of the nature and scope of its activities and the JV's longer term objectives and benefits. If this alignment of interests is not present, a JV is unlikely to be the best structure to use.

Typically the purpose of the JV would stem from one, or a combination of the following objectives:

- Value capture - The desire to capture long term value, from say property development or a commercial opportunity. A JV provides an alternative mechanism for capturing longer term value, as the public sector body will hold an equity stake in the JV.
- Route to market - The need to establish a new route to market for intellectual property or other assets. This is generally coupled with a desire to share in value capture as above.
- Service delivery programmes - The need to manage a long-term programme of service delivery and/or investment in order to improve the delivery and efficiency of public services and infrastructure justifies the formation of a separate self-standing and sustainable organisation. This would include, for example, Building Schools for the Future (see Section 1.6.2).

However, JVs place a significant requirement on the public sector for investment discipline and understanding plus appropriate powers to invest to be in place. In particular, different types of public sector body have different legal powers, different funding regimes, different governance arrangements, internal resources and access to advice – all these may have implications for what is achievable and appropriate given the scale of activities involved. JVs also raise a natural conflict where the public sector is at the same time both an approver and investor (in, for example, the UK NHS Lift model – See Appendix B).

Examples of long term service contract models in practice

Under the DBFO model, Council enters into a contract with a private sector consortium to design, build, finance, maintain and operate an asset for a specified period. An availability based DBFO model has been used in the two high profile NZ PPPs to date, Hobsonville Schools PPP and Wiri Prison PPP (see Section 2.3). Additionally, Wiri prison adopted a full service model approach that included custodial services. The DBFO model is also the basis of Treasury guidance, the NZ standard PPP contract, and the Private Finance Initiative (PFI) model used extensively in the UK (see Section 2.4.1).

The BOOT model is similar to the DBFO model except that the SPV owns the asset during the specified operating period and then must transfer the completed asset back to Council. The Auckland City Council agreement for the Vector Arena contained many aspects of a BOOT scheme.

Case study 3 : Vector Arena

The Auckland Council contract for the Vector Arena represents an existing example of an NZ PPP. In entering the agreement, the key objectives of the Council were to develop and operate a world class multi-use indoor sports and entertainment arena, ensuring reasonable charges for Community Events and no cost and minimal risk to the Council, but for the Arena to operate as a financially successful business, while maximising positive social impact and minimising any negative social or environmental impact.

As per a typical BOOT scheme, under the terms of the agreement, the private sector project company has an obligation to design, construct, operate, maintain and repair the assets, together with the rights to levy charges and generate revenue from the assets. Ownership and legal title of the assets remain vested in the project company until the end of the rights period (40 years), with ownership and title of the Project Assets reverting to the Council at the end of this period. In addition, the Council funded a proportion of the construction costs through a pre-payment for the assets. An innovation of this scheme is that the Council receives a small proportion of revenues during the rights period.

The UK Building Schools for the Future (BSF) programme is an example of a joint venturing (see Section 1.6.2). While it used a Strategic Partnering model, it used a joint venture structure to deliver the programme.

1.2.3. Long term partnering models

Long term partnering models (including Strategic Partnering and Integrator models) are typically used to deliver a programme of asset delivery over the longer term, and have the following characteristics:

- A long term partnering approach with an emphasis on collaborative working
- Allows for bundling of smaller projects
- Access to a range of procurement approaches
- Open book accounting to ensure cost transparency

1.2.4. Advantages and disadvantages of long term partnering models

Both Strategic Partnering and Integrator models provide the following benefits:

- Lower procurement costs over programme life as formal procurement processes are not required for projects once partnering relationship is established.
- Flexibility to deliver future known and unknown projects through a range of contractual mechanisms.
- Early commercial input from private sector partner(s)

The relative advantages and disadvantages of the two different approaches are outlined in the table below:

Table 3 : Relative advantages and disadvantages of long term partnering approaches

Model	Advantages	Disadvantages
Strategic partnering	► Public sector can retain influence over strategic decision making ► Potential for continuous improvement throughout successive phases of work ► Builds in flexibility ► No need for repeat procurements (with associated time and cost)	► Reliance on benchmarking and market testing to validate Value for Money ► Lack of competition post partner appointment
Integrator	► Involvement of a wide range of organisations ► Integrator incentivised to manage time and cost	► Appointment takes place before any formal tender of works ► Lack of integrated supply chain

Circumstances when long term partnering models are suitable

Long term partnering models are suited to phased programmes of projects, where the creation of a long term partnering arrangement can respond to a range of infrastructure and deliver cost efficiencies over a significant time period.

The introduction of long term partnering models can make the biggest positive impact in situations where current procurement and delivery scenarios and outcomes are “chequered” and where smaller projects could be aggregated (or bundled) to create critical mass.

Strategic Partnering may also be appropriate where the investment needs of a population over a prolonged period of time often in a dynamic area of public service are not predictable (e.g. primary healthcare and community facilities in the case of the Scottish hub programme and NHS Lift – see Section 1.6.2). While under long term service models the public sector enters into a contract with the private sector to build, operate and fund a pre-determined number of premises in a certain area, the population-based model means the public sector partners presents the private sector with the opportunity to enter into a genuine partnering agreement for a defined population with unpredictable needs.

However, the private sector partner is required to operate at a strategic level in line with the developing service and investment needs of the local population, and the population based model cannot guarantee deal flow to the private sector. NHS Lift has not delivered as much new investment as expected in some areas. This has impacted private sector returns and created partnering tensions in some localities.

Long term partnering models require a sophisticated client side requirement, which ideally (but perhaps not critically) procuring bodies would already be familiar with through existing application of alternative delivery scenarios such as DBFO. In addition, overseas evidence indicates local participant and general stakeholder “buy-in”, appetite and support is critical to the success of such models.

1.2.5. Examples of long term partnering models in practice

There are a number of examples of strategic partnering in the UK. One example is the NHS Local Improvement Finance Trust (NHS Lift) model introduced in the UK in 2000 as a private finance initiative (PFI) model for improving and developing frontline primary, community and social care facilities. Under the LIFT programmes, the private sector partners were selected based on a competitive process that involved parties providing priced bids for the first tranche of investments and methodologies to take forward future investments over time. The successful parties then entered into 25 year contracts with the NHS under which they were contracted to deliver the first investment tranche plus future investment tranches. Further details of this programme are provided in a Case Study at Appendix B.

Other strategic partnering examples in the UK are the Building Schools for the Future (BSF) and the Scottish hub programmes.

Case study 4 : Scottish hub programme

The Scottish hub programme was developed in 2007 to provide sustained investment in new Community Based Infrastructure across community planning partners (Health Boards and Local Authorities) increasing the scale of joint working and co-location. Its objectives were to deliver a greater amount of investment and deliver it more effectively and efficiently, and to act as an agent to deliver policy outcomes: Efficient Government, Shifting the Balance of Care, Joint Futures Policy.

Building on learnings from the NHS Lift and BSF models, the hub programme is an example of Strategic Partnering developed as a flexible long-term approach to the procurement and delivery of community based facilities through local joint venture arrangements, supported by a national delivery vehicle. The principles and structure of the contractual arrangements are very similar to those of the NHS Lift programme (see Appendix A).

The hub investment programme is now the flagship delivery model of Scottish Ministers investment plans in community based Infrastructure. The initial pipeline of projects are currently in procurement and represent the commencement of a master planned investment programme.

Case study 5 : Building schools for the future (BSF)

BSF was launched in 2004 to "rebuild every secondary school in England" through a combination of new build schools and the refurbishment of existing schools to 21st century standard (including the provision of the latest technology).

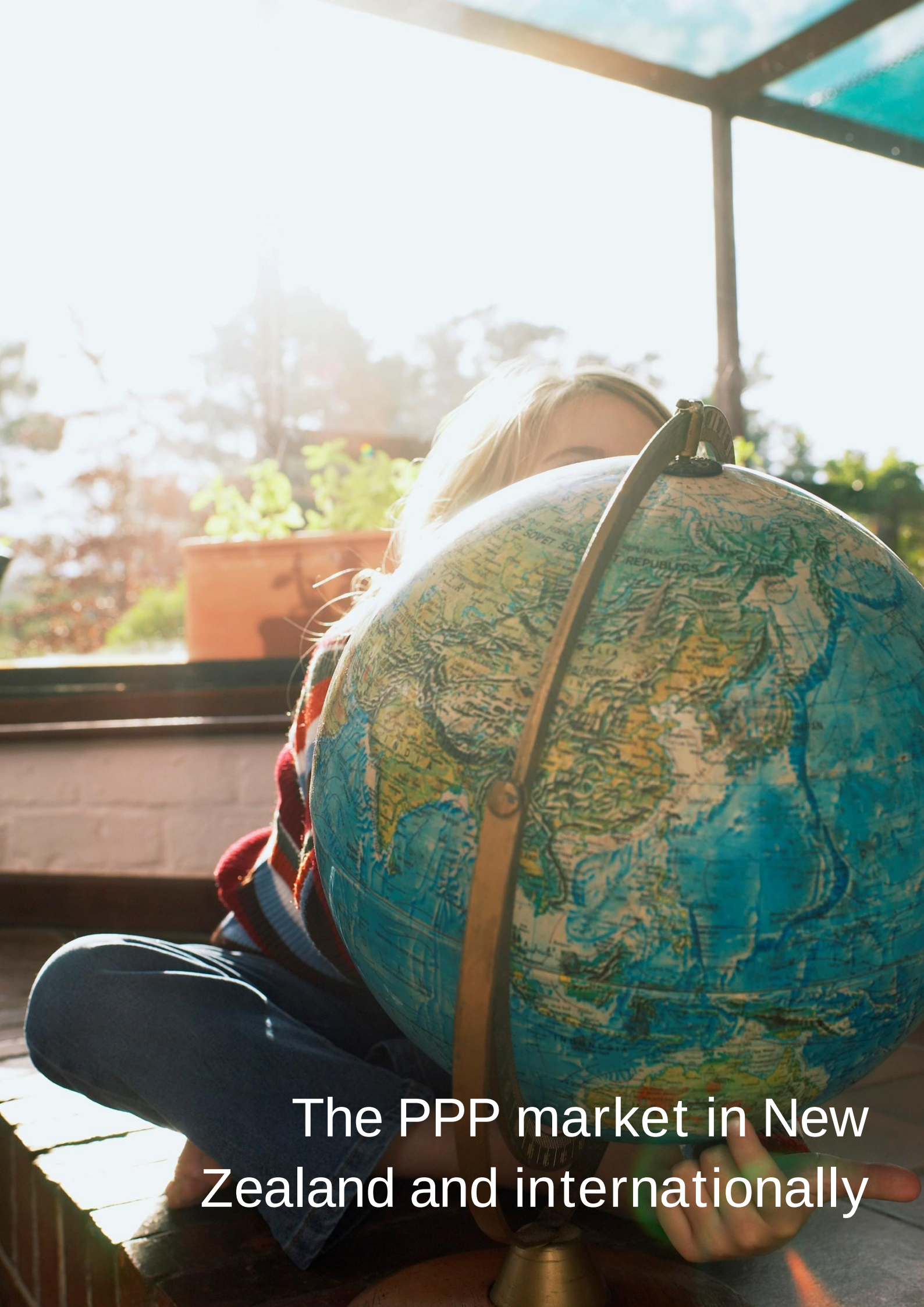
A lack of a co-ordinated investment across England and empirical evidence linking under investment in appropriate facilities to achievement meant that new facilities were required as a catalyst to improve attainment. BSF was about initiating a step-change in children's education and providing an environment for educational reform.

BSF specifically allowed for a mixture of PFI (PPP) projects for new build schools and traditional procurement for refurbishments.

However, BSF attracted a number of criticisms, in particular that it was unnecessarily bureaucratic and that original targets and budgets were too ambitious. In 2007, the Schools' Minister acknowledged that local authorities in the first three waves of the programme had lacked the management expertise and capacity to oversee such big projects. In addition, rebuilding numerous schools in an area, sometimes reshaping the educational provision in the process, takes time to plan, prepare and consult upon. As a result, the process took a lot of head teachers' time.

The scheme was axed in 2010 with some 180 school rebuilds / refurbishments complete and over 200 other schemes in construction.

These UK models provide a flexible long-term approach to the development and procurement of community based facilities, through local corporate and commercial joint venture arrangements supported by central delivery and management. As well as improving the efficiency of delivery of community based facilities, maximising the best use of public resources and encouraging continuous improvement in both cost and quality, these models can also act as a catalyst to promote joint planning and joint working, co-location and integrated service delivery and joint asset management.



The PPP market in New Zealand and internationally

2. The PPP market in New Zealand and internationally

2.1. Introduction

Under the National Government, infrastructure investment and the facilitation of this investment through PPPs are priorities high on the political agenda. The Government stated (March 2010) that "it will use PPPs where they can be demonstrated to provide clear VfM and where they will improve service delivery outcomes".

Consistent with this was the publication of the National Infrastructure Plan in March 2010 (and subsequent update in 2011) which outlined Government's infrastructure priorities, described the planned investment and provided a snapshot of potential joint public and private infrastructure investment opportunities across a range of sectors.

PPPs are now a recognised and successful procurement model in New Zealand. They have been used overseas for a number of years in countries such as Australia, the UK, Europe, the USA and Canada.

2.2. Background

This emphasis on using PPPs to deliver economic and social infrastructure in New Zealand has been driven by a number of factors, in particular:

- A lack of public sector funding for significant upfront capital expenditure, both at a local and national level. Under long term service contract approaches, the significant upfront capital expenditure involved in procuring new infrastructure assets can be financed through private investment, with public sector payments for the infrastructure and related services spread over the life of the concession period.

However, when considering PPP approaches, it is important to understand the difference between funding and finance. Funding is how infrastructure is paid for. Finance describes the money that has to be raised upfront to deliver the infrastructure, and it needs to be repaid. Infrastructure must be paid for irrespective of how it gets financed.

PPPs: Financing vs funding

Under a number of PPP approaches, upfront capital expenditure may be financed by the private sector. A private sector partner will invest equity and take out a loan to fund the capital elements of the project.

In some circumstances, the new infrastructure assets may be self funding (for example, a toll road that generates cash revenue, or a street lighting project that generates significant energy savings).

However, where the new assets do not generate a revenue stream (for example, a school or a hospital), the public sector will still be required to fund the repayment of this investment. Typically this funding requirement will be funded through taxes and spread over the concession period.

The central issue constraining greater private sector financing of infrastructure is the lack of available funding, and not access to capital. A PPP approach should only be adopted where there are significant value for money arguments for doing so, and not purely as a financing tool.

- A lack of focus on whole of life cost. Transferring responsibility for the maintenance and operation of assets under a long term service contract incentivizes whole of life cost optimization.

- The occurrence of sub optimal procurement processes (sometimes) with PPP, based on overseas experiences, viewed as a way of improving overall procurement outcomes

To support this focus on alternative procurement and infrastructure development, in 2009 Government established the National Infrastructure Unit (NIU). The NIU's role is to take a national overview of infrastructure priorities, providing cross-Government co-ordination, planning and expertise. Its responsibilities include:

- Formulating, and monitoring progress on, a 20-year National Infrastructure Plan.

- Establishing robust and reliable cross-Government frameworks for infrastructure project appraisal and capital asset management, and monitoring the implementation and use of those frameworks.
- Providing support to, and acting as a secretariat for, the new National Infrastructure Advisory Board.
- Providing support and guidance to Government agencies in the preparation of PPPs (this responsibility has now been transferred to a PPP unit within Treasury)

Since the formation of the NIU, Treasury has issued standard business case guidelines (the Better Business Case guidelines) for capital investment, specific PPP guidance (Guidance for Public Private Partnerships (PPPs) in New Zealand), a PPP Standard Contract and an updated National Infrastructure Plan.

NZ definition of PPP

While the PPP guidance recommends Departments consider a broader range of procurement options, when referring to PPPs the guidance, Treasury and the NIU generally refer to the design, build, finance, maintain and operate (DBFO) approach as the default non-traditional procurement option. The DBFO approach forms the basis of the PPP Standard Contract, and should be considered for all projects with a whole of life costs in excess of $25 million. The DBFO model was also the approach under which the two high profile PPPs in New Zealand to date (Hobsonville Schools PPP and Wiri Prison PPP) were procured.

2.3. PPP activity in New Zealand

As at mid 2013, progress in taking forward PPPs in New Zealand is gathering momentum and significant progress has been made in creating support for PPPs as well as increasing the understanding of PPPs and the benefits that they can offer which are similar across different sectors. This should ultimately create a platform where organisations like Auckland Council can engage openly and confidently knowing views will be heard and best practice followed.

Two PPP pathfinder projects have been supported by Treasury and have successfully reached financial close – the Hobsonville Schools Ministry of Education project and the Wiri Prison Department of Corrections project.

Case study 6 : Ministry of Education: Hobsonville Schools PPP

This project involves the development of a new primary school and a new secondary school at Hobsonville Point in Auckland. The private sector party is responsible for the design, construction and financing of the assets, together with the provision of ongoing asset maintenance and soft facilities management. On completion, the contractor will receive quarterly payments based on performance, with deductions for non-availability of teaching spaces or failure to meet specified performance indicators.

This project reached financial close in April 2012 with the Primary School now open and the Secondary School due for completion in January 2014.

Case study 7 : Department of Corrections: Wiri Prison PPP

This project involves the development of a new 960 prisoner men's Prison at Wiri. A full service model approach was adopted with the private sector responsible for the provision of custodial services in addition to design, construction, financing and operations (asset maintenance and soft FM).

The full service model approach was unusual (based on international precedent), however, the Department of Corrections was clear that the rehabilitation of prisoners was their main priority, and they wanted to use the PPP approach as a way of changing prison outcomes at Wiri and across the estate.

Under the terms of the contract, in addition to payment based on performance, the contractor receives incentives for reducing recidivism levels. Whilst ground breaking, this approach was embraced by bidders and highlights the significant benefits that can be achieved through an outcome based approach to procurement.

This project reached financial close in September 2012 and is under construction, with the Prison due to receive prisoners from April 2016.

Further projects are in the market or pipeline, including:

- New Zealand Transport Agency (NZTA): NZTA have completed an Expression of Interest process and invited two bidders to submit RfP responses for a DBFO project comprising a new road at Transmission Gully
- Counties Manukau District Health Board (CMDHB): CMDHB are finalising their Indicative Business Case involving new and reconfigured health services in Manukau
- Department of Corrections: Redevelopment of Auckland East maximum security prison
- Ministry of Education: Further round of schools PPPs, building on the success of Hobsonville

While most PPP projects in New Zealand to date have been applied to central Government assets, with the right incentives and scale, PPP models can be successfully applied at the local Government level. The amalgamation of the eight former, separate councils has provided Auckland Council with increased scale which, together with the recent increase in the period of concessions that local Councils can offer for transport projects, provides Council with more opportunity to consider PPPs.

2.4. PPP activity internationally

There is much international evidence of PPPs being used extensively over the last 20 years, including across Europe, Australia, the USA and Canada. Due to the amount of data available, this section focuses on PPP activity in the UK and Australia only.

2.4.1. PPP activity in the United Kingdom (UK)

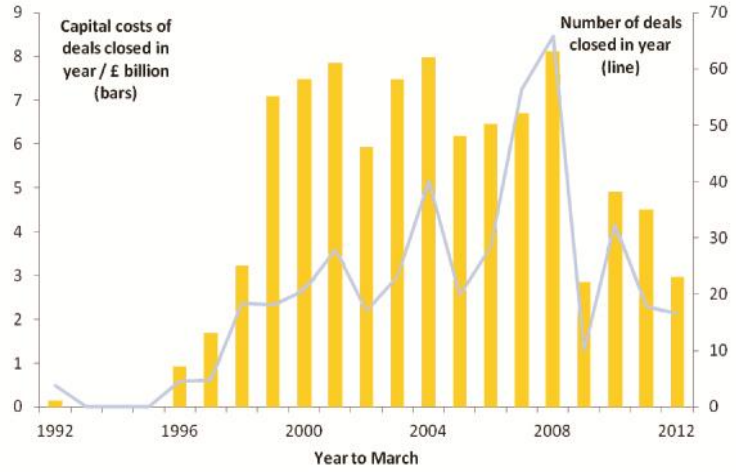
PPP approaches have been used extensively in the UK, most significantly through the Private Finance Initiative (PFI) model.

2.4.1.1. The Private Finance Initiative (PFI)

PFI was launched in the UK in 1992 as a way to deliver public sector assets and services in partnership with the private sector. The PFI model is consistent with the DBFM / DBFO model contemplated in the Treasury definition of PPP and the PPP Standard Contract and over the last 20 years has become the form of Public Private Partnership (PPP) used most frequently in the UK. It has been used across a broad range of sectors including to deliver schools, hospitals, highway maintenance, street lighting, waste management, social care, prisons, libraries, fire stations and more.

Since PFI's introduction, over 700 projects have reached financial close, securing private sector investment of around £55 billion[7]. As at March 2012, there are 717 current projects of which 648 are operational[8]. The chart below shows the number of PFI projects to have reached financial close and total capital costs incurred annually since 1992. These figures exclude projects that have expired or terminated.

Diagram 3 : Number of projects reaching financial close and total capital costs incurred for current projects[8]



The chart shows that there was a reduction in the number of PFIs going to market from 2008 onwards. This was due to both the constrained fiscal environment of the post GFC world, and due to concerns raised about PFIs, in particular in terms of their inflexibility, lack of transparency and perceived waste.

While the UK Government recognises that PFIs have generated significant benefits, in response to the concerns raised about PFI, in 2011/12 the UK Government initiated a reassessment of PFI which identified the following weaknesses with the approach[7]:

- A procurement process that is often slow and expensive for both the public and the private sector, leading to increased costs and reduced value for money
- Contracts that are insufficiently flexible during the operational period, making alterations to reflect the public sector's changing service requirements difficult
- Insufficient transparency on the future liabilities of PFI projects to the taxpayer and on investor returns;
- Inappropriate risk transfer to the private sector resulting in a higher risk premium being charged to the

[7] HM Treasury, A new approach to public private partnership, December 2012
[8] HM Treasury, UK Private Finance Initiative Projects: Summary data as at March 2012

public sector

- The perception that equity investors in PFI projects have made windfall gains, leading to concerns about the value for money of projects.
- A PFI credit regime that provided a budgetary incentive to pursue PFI and, thereby, undermined a genuine appraisal of the optimal delivery route and meant that procurement decisions of Government departments were sometimes skewed.

The UK Government continues to believe that private sector investment, innovation and skills should continue to play a significant role in the delivery of public infrastructure and services, however, as a result of their review of PFI, the Government has now introduced a number of reforms including a new approach, PF2 for involving private finance in the delivery of public infrastructure and services. This approach is aimed at providing improved value for money to the public sector and taxpayer.

The approach to be taken to structuring PF2 contracts, allocating risks between the public and private sector parties and promoting a common understanding of the new model in the market, including drafts of the new standard form services output template, pro forma payment mechanism, and shareholder arrangements will be published shortly for consultation. Following this they will be incorporated into "Standardisation of PF2 Contracts" which will then be republished in final form. The first confirmed programme to which PF2 will be applied is the £1.75 billion privately financed element of the Priority Schools Building Programme (PSBP).

Summary of reform measures in PF2

The key measures taken to achieve this include:

- Equity: To ensure better alignment of objectives, greater transparency and improved VfM, Government will look to act as a minority equity co-investor in PF2 projects and will introduce funding competitions for a proportion of equity to attract long-term investors into projects prior to financial close
- Accelerated delivery: The Government will introduce measures to ensure procurement is faster and cheaper than in the past, and to improve public sector procurement capability
- Flexible service provision: To improve the flexibility, transparency and efficiency of services, soft services such as cleaning and catering will be removed from projects, procuring authorities will have discretion on the inclusion of certain minor maintenance activities at the project outset and there will be additional flexibility to add or remove certain elective services once a contract is in operation, together with a gain share mechanism for any surplus lifecycle funds;
- Greater transparency: The Government will introduce measures in order to improve the transparency of PFI arrangements
- Appropriate risk allocation: To improve value for money there will be greater management of risks by the public sector, including the risk of additional capital expenditure arising from an unforeseeable general change in law, utilities costs, site contamination and insurance.
- Future debt finance: PF2 will be designed to encourage the assessment and use of a greater range of debt financing sources to secure affordable, value for money long-term debt finance.
- PFI credits: Abolishing PFI credits in order to create a level playing field for all forms of procurement

2.4.1.2. Other PPP approaches in the UK

While PFI is the most frequent form of PPP used in the UK, other models that have been used in the UK include:

- Strategic Partnering - including LIFT, the Scottish hub programme and Building Schools for the Future (BSF) (see Section 1.6.2)
- Alliancing - including the London Olympics and Heathrow Airport expansion
- Hybrid models – Prime contracting contains elements of the Early Contractor Involvement models and Strategic Partnering. While contracts are based on an output based specification with clear allocation of risk and a single point of responsibility for whole service procurement, Prime Contracts place greater

emphasis on partnering and collaborative working, with all parties involved at the front end of the design process and greater degree of contractor involvement in decision-making processes. Other features include a co-located Integrated Project Team and shared objectives, risks and rewards.

Prime Contracting

A Prime Contractor is one having single point responsibility for the management and delivery of a project using a system of incentivisation and collaborative working to integrate the activities of its Supply Chain members to achieve a project that is on time, within budget and is in accordance with the specified outputs and is Fit for Purpose.

Prime Contracting was used by the Ministry of Defence (MoD) in the UK to reduce their total number of separate works and support services contracts by bundling requirements into fewer larger integrated "one-stop shop" contracts, including Project SLAM (Single Living Accommodation Modernisation programme).

Case study 8 : Project SLAM (Single Living Accommodation Modernisation)

Project SLAM is a MoD wide project for the upgrading of single living accommodation over a 10-year period, which covers 240 projects at over 100 establishments. The contractor is responsible for the modernisation, including refurbishment and new build (design and construction), of 16,000 bed spaces together with 7 year maintenance of the new and refurbished facilities, and rewarded through an incentivised price and costing regime. The first contract, awarded Dec 2002, was for 5 years with a 5 year extension. Each phase was valued at circa £500 million.

An appraisal of the project has showed improvement in performance and value for money time. The scale of the programme, repeat nature of work and the use of standard designs has generated efficiency improvements, with the first phase generating a 9% saving in the target cost and a further 9% targeted during Phase 2.

2.4.2. PPP activity in Australia

PPPs have been used nationally and by States and Territories in Australia over the 10 to 15 years. The establishment of *Partnerships Victoria* within the Victorian Department of Treasury and Finance in 2000 led to the development of PPP-specific guidance based on the UK PFI model. PPP policies in other Australian jurisdictions are based on the Victorian policies. In 2005, the federal and all State governments formally agreed to harmonise their approach to PPP development and implementation. Infrastructure Australia now has carriage of PPP policy and guidelines in Australia. Nevertheless there are still differences between jurisdictions and the guidelines recognise jurisdiction preferences and in particular in the commercial principles. To date and unlike the UK there is no standard form of PPP contract in Australia.

2.4.2.1. PPP sectors

Australian PPPs have been used for delivering projects such as major toll roads, hospitals, prisons, schools, convention centres, utilities and sporting facilities. The PPP model was conceived to be broad ranging but has tended to be constrained in Australia to the high capital cost and more complex projects. Australian PPPs are concentrated on two broad models:

- For social infrastructure - design, build, finance and maintain models (DBFM) with varying degrees of service provision. This model has been in use since 2000 and closely resembles the UK's PFI model (and Hobsonville Schools). In these arrangements, the Government assumes demand risk. In the 1990s Australia used the full services design, build, finance, operate (DBFO) model (Wiri Prison) to develop prisons (for example, Port Philip and Fulham in Victoria) and hospitals (for example, Latrobe Regional Hospital and Mildura Base Hospital). In the 2000s consecutive Labor Governments introduced PPP policies that excluded full services under what was known as "core service" remaining under public sector operation. The recent wave of conservative Governments coming to office in Australia is giving a resurgence of the full services model (for example, Ravenhall Prison in Victoria).

- For economic infrastructure - user pays models, typically used in toll roads. Characteristic of this model is the transfer of revenue risk to the consortium. In these arrangements, there is no direct Government revenue guarantee. In the case of toll roads, the revenue stream is received directly from motorists.

Transport infrastructure has historically accounted for the lion's share of project finance deals in the Australian market – US$42.4 billion between 2006 and 2011, or 46 per cent of deal volume. The development of roads has been flagged as a priority area by the Government, but developing roads as PPPs presents challenges in the Australian market. Overly-aggressive traffic forecasting has led to the under-performance of a number of PPP toll roads. As a consequence, Infrastructure Australia are currently exploring various procurement and funding models for privately financed infrastructure, especially in the transport sectors with the latest PPP roads deal (Peninsula Link, Victoria) procured on an availability basis.

Some of the largest deals in recent years have been in the social infrastructure sector. The A$2.9 billion Royal Adelaide Hospital PPP was one of the largest deals to reach financial close in 2011, and is one of the country's most ambitious PPP projects as yet. The A$1 billion Victoria Cancer Centre reached financial close in December 2011, due to open in 2016, and Sunshine Coast Hospital in 2012. The A$360 million Bendigo Hospital PPP is currently in procurement (DBFM and at BaFO) and the Northern Beaches Hospital in NSW is rumoured to be heading down the full service DBFO model.

Case study 9 : Australian tolls roads

In recent years the Australian Toll Road market experienced a number of projects where actual traffic has been significantly below the levels estimated by the private sector in structuring and financing their bids – resulting in financial distress for the project companies.

This has resulted in a significant equity write downs for the private sector and in some projects has resulted in the banks writing off debts. However, the risk allocation in these structures held and Government has not had to bear any additional costs resulting from the shortfall in traffic. In all projects the roads have been built to specification and have remained operational throughout the period of financial distress.

Examples include the Sydney Cross Tunnel, Lane Cove Tunnel, Clem 7 Motorway and Airport Link. According to one study, traffic was 45 per cent lower than predicted on five out of 14 toll-roads in Australia[9] . For the Sydney Cross Tunnel, which filed for bankruptcy in 2007, traffic volumes were forecast at 90,000 vehicles a day, but only hit 20,000 during the first week of tolling.

As a consequence of the private sector losses there has been a significant change in greenfield project traffic risk appetite from equity and debt financiers for future toll road projects – meaning there is no or very little private sector appetite for greenfield traffic risk. Therefore alternative delivery models will be developed for future road projects including East-West Link in Victoria and WestConnex in NSW. This will likely result in Government taking a greater share, if not all, greenfield traffic risk until such time as the project and revenues are established.

2.4.2.2. Current PPP market

While there have been many successful PPP projects in Australia, PPPs have been subjected to considerable controversy following some high profile 'failures' that have featured in the media (for example, Ararat Prison in Victoria and the under-performance of some toll roads). In addition, critics have pointed to high bidding costs associated with PPPs, refinancing issues, cost overruns, construction failures, design irregularities, windfall profits, lack of transparency etc.

[9] Li and Hensher, 2009, cited in *AMP Capital Infrastructure Quarterly Report*, August 2011

Case study 10 : Ararat Prison

The $400 million Ararat Prison PPP in Victoria collapsed last year when the two builders St Hilliers and Hawkins Construction struggled to meet their obligations under a construction joint venture. Bilfinger Berger (BB) issued a press release on June 13 2012 which confirmed insolvency of Ararat JV special purpose company called Aegis Correctional Partnership Pty Ltd (ACP) that is half-owned by CBA and half by BB. BB wrote off its $19 million equity investment, a material loss.

Unusually, (and unfortunately for Ararat JV and the Government), the two construction companies had managed to form a construction joint venture company with limited liability and no recourse back to parent companies under the security arrangements, resulting in insufficient security under the contractual arrangements to mitigate the significant risk of financial distress at the joint venture level. This has now been identified as an area of focus by the Department of Treasury and Finance in its recent discussion paper released in December 2012, Future direction for Victorian public private partnerships. It is likely that on future projects Government will carry out extensive due diligence on the financial capacity of the underlying companies delivering the services and look to strengthen security arrangements back to parent companies. Given what has happened on Ararat it also seems unlikely that PPP project sponsors will form consortia without including major tier one builders. The consequences of Ararat are yet to play out, but in the short term at least it may constrain the field of construction companies able or willing to bid for PPPs in Australia (but does not appear to have reduced market interest for the Transmission Gully project in New Zealand).

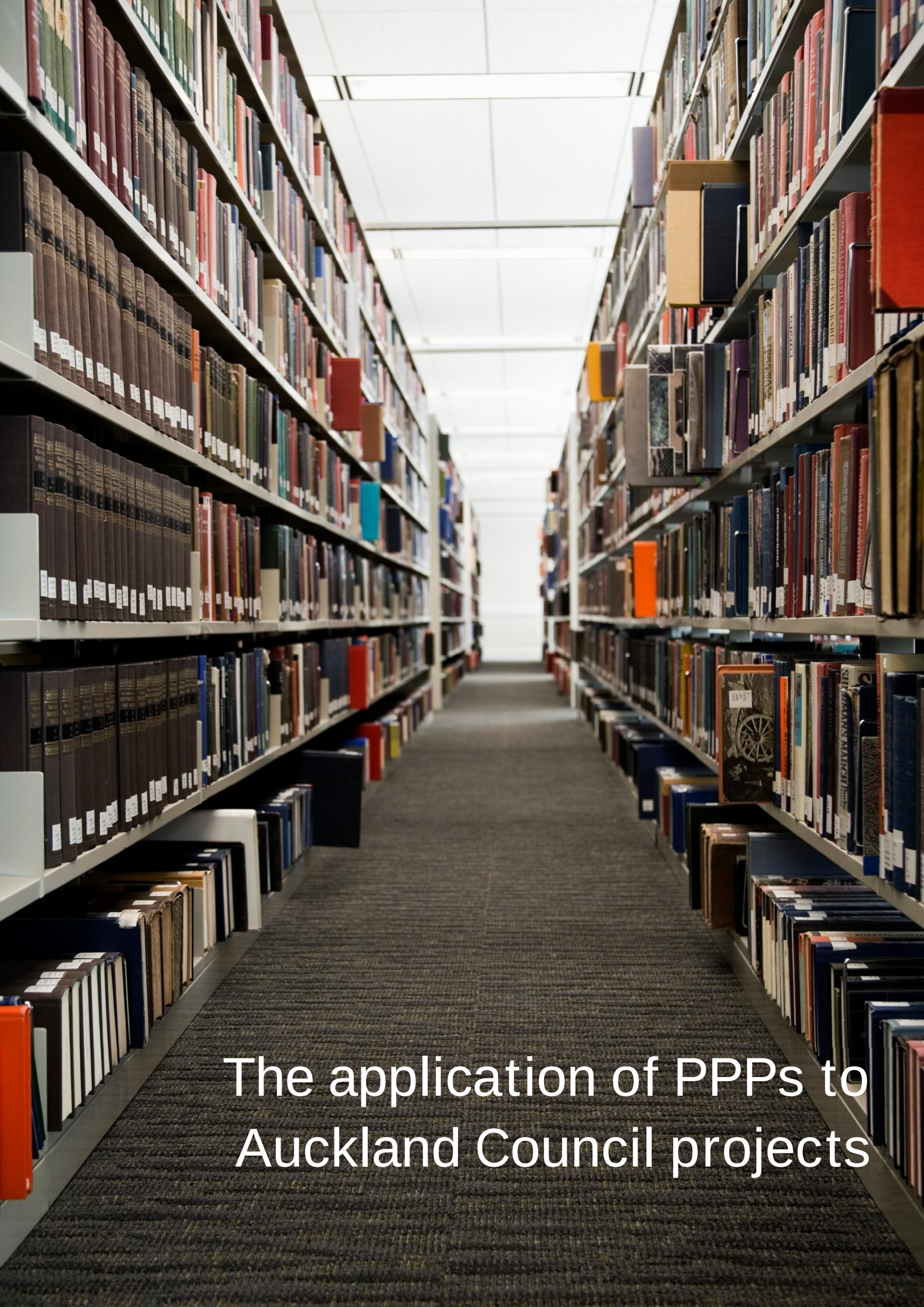
Under the contract Government is under no obligation to make payments to the consortia until the services phase of the project and has not relieved the private sector of its substantive obligations under the contract. Fortunately for Government, the CBA stepped up to its obligations not only as a significant provider of debt, but also as holder of equity. However, unlike in a typical, well structured PPP where sufficient support is in place to protect the public sector from bearing additional costs should the private sector partner become insolvent (see Section 4), it is unclear at this point who will bear the brunt of any cost overruns.

The prison project is to be completed by 2014 under a revived PPP. The deadline for completion of the project, which includes a new 358-bed facility, has been pushed back from December 2012, to 2014. The resurrected project remains a PPP, headed by the CBA. The collapse left at least 45 subcontractors owed up to $25 million by the consortium, and has had a major impact on the Ararat economy.

The ongoing impacts of the GFC also continue to affect PPPs globally. While the project finance market in Australia has shown some resilience, PPPs face numerous funding challenges in the form of the limited availability, limited tenor and an increased cost of bank debt. Added to this is a smaller pool of PPP equity investors, especially ones who are willing to take on both construction and refinancing risk together with being liable for growing bid costs. On the other hand, infrastructure funds such as John Laing, Morrison and Bilfinger Berger, Infrared, Lloyds / Bank of Scotland are all investing in Australian and NZ based teams. Nevertheless, Governments have continued to develop PPPs and look for ways to support financial markets and deliver value for money. At the height of the GFC, when liquidity was a significant issue, the Victorian Government provided a syndication guarantee that enabled its desalination project to get financed. More recently price has been the significant issue and Governments have shown a willingness to provide capital contributions to reduce the overall debt burden, for example, VCCC and Sunshine Coast hospitals both include capital contributions as does the current in procurement Bendigo Hospital.

The PPP model is being called into question, with a number of public bodies in Australia revising their views on a range of issues relevant to the PPP model. The Victorian Government has recently released the "Future direction for Victorian public private partnerships: request for public comment" paper for public consultation which, with similar objectives, in part suggests some of the same reforms to those contained in PF2 in the UK. One key difference to the UK reforms is that, while PF2 talks about removing soft services from PPPs, there is some consideration of the full service model in Australia.

However, there is clearly a future for PPPs in Australia. State and federal Governments have several potential infrastructure projects headed for the PPP model, including the M4 East Toll Road and other road projects in NSW; road and rail projects in Victoria under the Victorian Transport Plan; and the Brisbane Cross River Rail in Queensland. The full services DBFO model is once again back on the agenda, for example, Ravenhall Prison in Victoria which is following the Wiri path in New Zealand. The Victorians are considering broader PPP models for housing and smaller projects and have canvassed these in the recently released discussion paper.



The application of PPPs to Auckland Council projects

3. The application of PPPs to Auckland Council projects

3.1. Introduction

Auckland Council now oversees all of Auckland from Te Hana in the north to Pukekohe in the south and is responsible for operations and services as diverse as:

- Maintaining more than 7,000km of roads and 6,500km of footpaths
- Stocking 54 libraries and 4 mobile libraries in 21 local board areas
- Managing assets valued at over $36 billion

In the Long-term Plan 2012 – 2022 (LTP), it is forecast that, in order to maintain its assets, cater for growth and deliver the level of service improvements required to deliver on the Auckland Plan vision, Auckland Council will invest $20 billion of capital expenditure in providing new assets as well as renewing and upgrading existing assets and spend $38.7 billion of operating expenditure over the next 10 years.

Auckland Council has historically procured major capital expenditure projects using traditional procurement approaches centred on construction based models, with elements of risk transfer to the private sector in terms of design and construction but generally with no ongoing obligations in terms of asset maintenance and operation. However, traditional delivery models have limitations which may not enable Auckland Council to achieve the best value for money and project outcomes in all circumstances. For large, complex or innovative projects, better value and project outcomes may be achieved by utilising a non-traditional delivery model.

Case study 11 : Street lighting PPPs

Street lighting PPPs have been proven to provide significant benefits including long term cost savings and qualitative environmental and safety benefits.

Investment in new street lighting technologies is attractive because it generates significant long-term cost savings and effectively pays for itself. In addition, new lighting technologies not only increase energy efficiency, they improve safety and reduce crime and carbon emissions.

The use of PPPs to deliver street lighting projects has been used globally for more than 10 years with considerable success. Most notably, in the UK, it has been applied on around 30 street lighting PFI projects since 1998 and is viewed as one of the most successful local government PPP sectors.

According to an article by John Reed, Project Director at 4ps:

By 2007, 4ps had undertaken operational reviews on 11 of the street lighting PFI projects in operation and found that the projects were delivering at or above expectations. There was a significant improvement in service standards, and local authorities were receiving good or very good feedback on user satisfaction. One of the key factors behind these successes was the partnering approach adopted by local authorities and service providers.

Using the PFI or a Public Private Partnership (PPP) for street lighting provision allows a local authority to obtain investment by a service provider for better and more efficient apparatus in order to improve the safety and performance of the street lighting service. The 'spend to save' benefits of this approach, together with the benefits of procuring the whole service rather than the individual components, demonstrates that procurement through the PFI or a partnership route is a better way to optimise whole life costs and service delivery[10].

[10] John Reed, Director 4ps (UK local Government partnership and project delivery specialist, analogous at a local level to NIU), 2007

Case study 12 : PPP as a catalyst for water infrastructure in Scotland

The Scottish public sector utilised PPP to invest in and upgrade waste water and water storage facilities in the mid 1990s. Following the success of these projects, the Scottish Government, applying many of the contracting benefits of these PPPs, established a delivery joint venture to deliver future investment and water management services.

3.2. The application of PPPs at the civic level

PPP projects in New Zealand to date have been applied to central Government assets and there is a lack of precedence for a civic model in New Zealand. However, with the right incentives and scale, PPP models can be successfully applied at the local Government level, as has been borne out internationally.

The successful application of PPPs at the civic level internationally has a lot to do with the scale of assets and projects that are the responsibility of municipalities / local Governments. Although experience varies according to location and community demands, local Governments generally have responsibility for a homogenous stock of assets, including roads, land and buildings, and invest a relatively small amount per annum in infrastructure. Infrastructure development and maintenance is dominated by local roads networks. Non-road projects can be substantial but at the individual asset level tend to be one-off rather than regularly procured.

For some local Governments, the absence of projects of sufficient scale and the lack of a clear pipeline results in a lack of engagement by the private sector in local Government infrastructure projects, because the private sector's appetite to take risk is dependent upon the quantum of return. In addition, a lack of project scale means that transaction costs can be a significant barrier to the implementation of complex procurement models. According to a study by SGS Economics & Planning, "the actual dollar size of the infrastructure contracts are, in many cases, insufficient to gain credibility with the private sector given the significant transaction costs associated with competitive tendering."[11] For example, whilst alternative procurement models are tried and tested in Australia, the adoption within the local Government sector has been limited primarily due to the absence of projects of sufficient scale within the sector.

However, the amalgamation of the eight former, separate councils has provided Auckland Council with increased scale providing more opportunity to consider PPPs. In addition, Government has recently increased the period of concessions local Councils can offer for transport projects, thereby making transport PPPs more viable.

Project scale

The Council invests approximately $2bn per annum on infrastructure assets. This includes the provision of new assets in addition to the renewal and upgrading of existing assets. Within this budget, there are significant one-off projects, in particular major transport projects, with a capital value well above Treasury guidelines for PPPs. For such projects, scale should not be a barrier to PPP.

For smaller projects, for example local facilities, a PPP model may provide benefits where multiple assets are bundled under a single outsourced contract. The Safer Local Roads program in Mornington Peninsula Shire, Australia, for example, which has created savings of around $65m over 15 years for the Council, involved bundling capital expenditure and maintenance for all local roads within the local Government area (see Appendix C). Alternatively, a PPP Partnering approach may be appropriate whereby a programme of similar assets are delivered over the longer term through a single private sector partner (see Appendix A: Strategic Partnering Case Study LIFT).

When considering scale, Auckland Council should consider the whole life costs of a project rather than the upfront capital value only. The benefits of private sector expertise and efficiencies can be significant for assets that do not necessarily require significant upfront capital expenditure but where there is considerable ongoing maintenance and lifecycle costs (see Case Study 13).

[11] SGS Economics & Planning, *Guidelines for a Local Government Infrastructure Financing Manual*, July 2002

Case study 13 : Project Aquatrine - MoD wide water and wastewater project

Project Aquatrine was launched in 1999 to provide strategic management of water and sewerage services across the MoD's estate by transferring risk to those best able to manage it, allowing the MoD to meet its environmental liabilities in this area and to focus on delivering its core objectives. This signalled a new approach, with recognition that the historical management of the MoD's water and wastewater estate had not been the most efficient, and that utilising private sector skills in a non-core area for the MoD represented the way forward, both in terms of better value for money, and better management of environmental issues.

The MoD estate comprises 4,500-plus sites, and the Project comprised three regional packages, over a 25 year contract term. With over 300 sites having significant above ground assets, over 80 boreholes, and supply to non MoD customers at over 800 sites, the scope for opening up competition was significant. In broad terms, the service provider was required to meet output service standards covering water supply, foul sewage, surface water, trade effluent, fire fighting, interruptions and emergencies, security and other related services, all external to the buildings.

While the Aquatrine packages required some upfront capital expenditure, this was not as significant as for a typical DBFO project that involves substanital new infrastructure (for example, a school or hospital). The project involved significant refurbishment and replacement of existing assets throughout the contract term.

Some of the key benefits delivered by the Aquatrine partners since the project was launched are:

- Significant investment to improve asset condition profiles
- Reduced leakage by over 25% across the Estate
- Support in achieving leakage reduction targets 11 years early
- Improved security of supply and improved compliance with Drinking Water Inspectorate standards
- Common Health and Safety reporting procedures
- Improved water provision infrastructure for fire fighting to comply with Crown Fire Standards

While scale can be a significant factor in determining the applicability of PPP models, it should not be an absolute barrier. With the right disciplines and commitment, PPP models can be applied to smaller projects (see Case Study 14).

Case study 14 : Leisure PPPs in the UK

In the UK, around 15 leisure projects have been procured under the UK PFI scheme. These projects ranged in value from under £10 million to around £35 million and generally involved sports halls, indoor swimming pools and, in some cases, fitness centres and other facilities.

The Lewisham Downham Lifestyles Centre in London, for example, is a £15m PFI project forming part of a regeneration scheme covering the entire borough. The project, signed in 2005, incorporates a combined health and leisure centre, with wet and dry facilities, alongside a library, Council service point and PCT health centre with two GPs, a dentist and local health clinic, all in a 20 acre park. Plans for the regeneration project also include mini-soccer facilities, a toddlers' play area, a dog-walking area, footpaths and bridges across the Spring Brook stream as well as 58 flats and 20 houses on the site of the former council depot.

Depending on the size and location of the leisure facilities required under the PFI projects, private sector providers were required to bid either an annual subsidy (or unitary charge) required from the public sector in return for the operation and maintenance of the facilities or, if anticipated third party revenue was greater than expected operating and capital costs, an annual amount to be paid to the public sector body by the private sector provider. These annual subsidies or payments are benchmarked every 5 years and hence the private sector is taking demand risk over 5 years.

Procuring projects of such small capital value in a cost effective manner required significant discipline and commitment from the parties. However, these projects provided community benefits over and above the standard benefits of a PPP. The inclusion of improved participation (in particular, of minority groups) as a KPI incentivised the private sector partners to increase attendance, thereby maximising revenues as well as providing health benefits to the community.

A strategic partnering structure could potentially improve efficiencies in procurement, alongside a commitment to standardisation in leisure PPP projects.

3.3. Auckland Council procurement policy implications

An overview of Auckland Council's procurement and PPP policies is set out in Appendix C. The PPP policy is consistent with Treasury guidance. As per Government guidance, the policy generally refers to the DBFO model, and the PPP criteria and risk management principles are consistent with the guidelines.

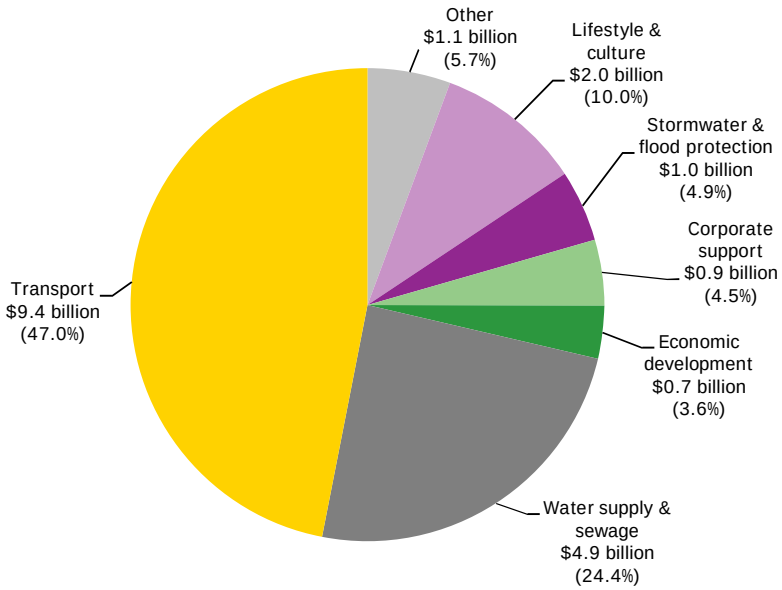
Whilst the policy provides a framework for considering a PPP (in the form of a long term service contract), it does not prescribe when such a PPP must be used or appear to exclude alternative procurement options, for example, ECI. The policy provides the Council with some flexibility in considering PPPs as a procurement approach, and enables Council to quickly identify which projects may be suitable for PPP procurement. However, unlike Treasury guidance, there is no requirement to consider a PPP where capital costs are above a certain threshold.

Undertaking a PPP should not contradict the Council's general procurement policy in terms of the six procurement principles in the Procurement Strategy, which recognise that all procurement decisions should consider the most appropriate procurement option to facilitate optimal outcomes. These principles can be achieved in the same way as under traditional procurement through the requirements, qualifying attributes and specifications of Council, and through a thorough business case process.

3.4. Auckland Council projects

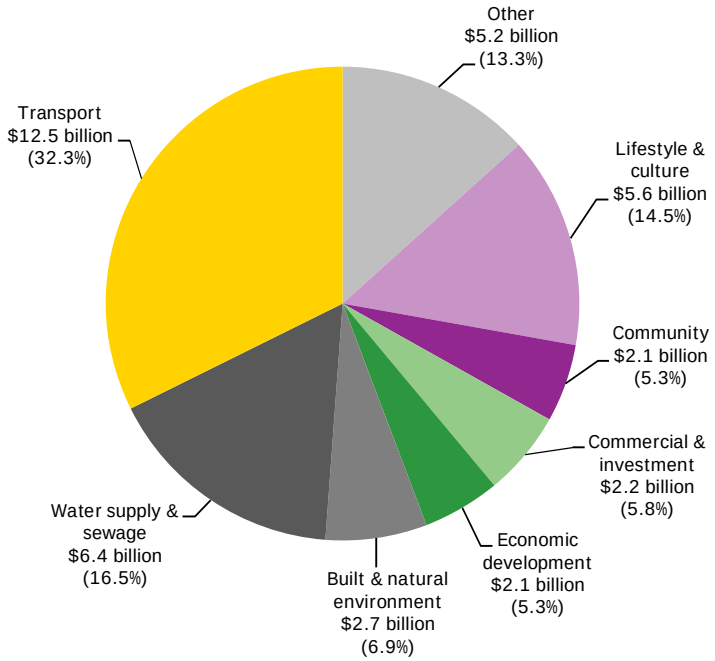
The charts below provide an overview of forecast capital and operating expenditure over the period of the LTP by activity theme and indicates that the majority of expenditure is forecast to be spent on transport, followed by water supply and sewerage, and lifestyle and culture themes.

Diagram 4 : Forecast capital expenditure by theme 2012-2022



Source: Auckland Council Long-term Plan 2012 - 2022

Diagram 5 : Forecast operating expenditure by theme 2012-2022



Source: Auckland Council Long-term Plan 2012 - 2022

These activity themes are further broken down in the LTP by "group of activity", together with high level information on forecast capital expenditure projects by group of activity.

The table below provides an overview of the key capital projects forecast within each group of activity, together with observations as to the likely project characteristics and an indication as to alternate procurement routes that could be considered for these projects. This analysis is based on a high level review of the LTP and exact details of the each of the projects are unknown. If Auckland Council wish to consider these alternate procurement routes further for these key capital projects, additional information and detailed analysis of the projects would be required.

Table 4 : Key Auckland Council capital projects

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
Transport			
Public transport and travel demand management Rail, ferry and bus passenger services and supporting infrastructure Multi-modal (transport hub) services to support the public transport network Work with communities to deliver road safety education, travel planning, walking and cycling Performance measures: ► Patronage ► Public transport subsidy per passenger kilometre ► Public customer safety and security incidents across network ► Customer satisfaction ► Effective infrastructure and services for walking, cycling and ride-sharing that help reduce single-occupancy car trips	► The City Rail Link (CRL) project - $3.04 billion over life of LTP, after allowing for the sale of surplus land	► Large scale and potential scope ► Long term service requirement ► Potential for innovation ► Significant up front funding requirement ► Commercial opportunities ► Significant risks (for example, tunnelling, interfaces - depending on scope and link to existing network)	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Spreading of payments ► Linking of payment to performance measures (for example, availability, travel time, safety) ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Long term cost and outcome benefits of operator influencing design ► Access to private sector finance ► Competitive tender process encouraging operational efficiencies
	► Electrification of the rail network - $494 million. Infrastructure associated with installing the electric system on the network is being funded by central Government; Auckland Transport is funding new trains and the upgrade of rail stations where necessary	► Large scale and potential scope ► Long term service requirement ► Potential for innovation ► Significant up front funding requirement ► Potential interface risk between trains, systems and operator	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Spreading of payments ► Linking of payment to performance measures ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Long term cost and outcome benefits of operator influencing design ► Access to private sector finance ► Competitive tender process encouraging operational efficiencies
	► Route protection and land purchase for airport link - $56 million	► Simple purchase	► None identified
	► Range of smaller projects associated with ferries, bus, rail	► Details unknown	► Potential to bundle projects and associated maintenance / operations into phased programme of works with a long term Partner
Roads and footpaths Providing well maintained roads and roading infrastructure Providing well maintained footpaths that encourage walking	► AMETI (integrated multi-modal infrastructure between Glen Innes and the Manukau city centre) - $716.6 million	► Long term programme of capital expenditure ► Potential to bundle works ► Long term maintenance requirement ► Potential for innovation ► Requirement for supply chain management	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Linking of payment to performance measures (availability, travel times)

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
Performance measures: ► Network productivity ► Travel times ► Percentage reduction in fatal and serious injuries on local road network ► Customer satisfaction – roads and footpaths			► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Competitive tender process encouraging operational efficiencies ► Potential to drive efficiencies through economies of scale / performance improvement
	► Build or improve footpaths and pedestrian facilities across Auckland - $500.2 million	► Long term programme of capital expenditure ► Potential to bundle works ► Asset renewals but no operations – minor interface issues ► Long term maintenance requirement ► Potential for innovation ► Requirement for supply chain management	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Linking of payment to performance measures ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Competitive tender process encouraging operational efficiencies ► Potential to drive efficiencies through economies of scale / performance improvement (through repeat nature of work / use of standard designs)
	► Albany Highway - $100 million and Penlink - $68.9 million	► Medium to large scale ► Potential to bundle together ► Long term maintenance requirement ► Potential for innovation ► Significant up front funding requirement	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Spreading of payments ► Linking of payment to performance measures (for example, availability, travel time, safety) ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Access to private sector finance ► Competitive tender process encouraging operational efficiencies
	► Dominion Road upgrades (to improve bus speeds and reliability) - $90 million	► Medium to large scale ► Renewal / refurbishment of existing asset - small part of existing network ► Interface risk – ongoing operations and existing network	► Competitive tender process encouraging cost efficiencies ► A team approach, with private sector expertise / experience harnessed early, creating opportunities for innovation and integration of construction methods ► Appropriate risk allocation - risks allocated to the party best able to manage them

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
Parking and enforcement Access to and turnover of affordable, safe on-street parking (which contributes to smooth traffic flows in the city) and affordable, safe off-street parking ► Performance measures include parking to meet customer demand	► Up to $65 million including upgrading on-street parking pay and display meters, and introducing pay and display machines in new areas at an estimated cost of $2 million over the life of LTP	► Limited annual capital spend and maintenance expenditure	► Access to private sector experience / expertise, creating opportunity for innovation ► Linking of payment to performance measures ► Appropriate risk transfer, in particular whole of life cost risk ► Competitive tender process encouraging operational efficiencies
Water supply and sewerage			
Water supply Providing safe drinking water to homes and businesses and long term planning of Auckland's water networks Performance measures include: ► Customer satisfaction ► Compliance with drinking water standards ► Unplanned interruptions and water shut downs ► Water quality complaints ► Water losses	► Hunua No.4 Water Supply Scheme involves the construction of a 35km trunk water main between the Redoubt North and Khyber Pass reservoirs - $339.1 million ► Huia Water Treatment Plant upgrade to increase capacity to 140MLD - $232.9 million ► North Harbour Water Main Duplication - $208 million ► Replacing and upgrading treated water network programme - $92 million ► Expanding Waikato Water Treatment Plant - $48.7 million	► Large scale and potential scope ► Long term service requirement (potential to link capital, maintenance and operating requirements) ► Potential for innovation ► Significant up front funding requirement ► Significant risks (for example, interfaces with existing network) ► Potential to bundle similar / smaller projects together	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Spreading of payments ► Linking of payment to performance measures (for example, compliance with water standards, leakage targets) ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Access to private sector finance ► Competitive tender process encouraging operational efficiencies ► Opportunity to bundle projects into phased programme of works with a long term Partner
Sewerage treatment and disposal Providing safe and healthy wastewater collection, transport and treatment Performance measures include: ► Customer satisfaction ► Bursts and chokes ► Dry weather sewer overflows ► Compliance with discharge consent requirements	► A new interceptor from Western Springs to the Mangere treatment plant - $797.1 million ► North Shore trunk sewer - $161.4 million ► Replacing, expanding and upgrading Rosedale and Mangere wastewater treatment plant - $148.2 million ► Rural wastewater treatment plant replacements, expansion and upgrades ► Sewer and pump station upgrades and replacements.	► Large scale and potential scope ► Long term service requirement (potential to link capital, maintenance and operating requirements) ► Potential for innovation ► Significant up front funding requirement ► Significant risks (for example, interfaces with existing network) ► Potential to bundle similar / smaller projects together	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Spreading of payments ► Linking of payment to performance measures (for example, compliance with consent requirements, overflows) ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Access to private sector finance ► Competitive tender process encouraging operational efficiencies ► Opportunity to bundle projects into phased programme of works with a long term Partner
Lifestyle and culture			
Regional and local arts, culture and	► Up to $38.5 million on capital projects such as	► Small scale developments with limited	► Competitive tender process encouraging cost

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
events services Includes: ► Arts culture and events policy ► Arts and culture facilities and initiatives ► Regional and local events	Lopdell House in Titirangi - $11.7 million, and the Glen Innes Music and Arts Centre for Youth - $8 million. ► A programme of arts and culture activities - $25.6 million	commercial opportunities	efficiencies ► A team approach, with private sector expertise / experience harnessed early, creating opportunity for innovation ► A programme approach to provide scale and accelerate later projects ► Appropriate risk allocation - risks allocated to the party best able to manage them
Regional events facilities Includes: ► Event facility support and management ► Stadium support and management Performance measures: ► Attendees ► Event days ► Visitor numbers	► The Civic and Aotea Centre upgrade and renewal - $94.3 million ► Mt Smart Stadium upgrade and renewals - $16.1 million ► Auckland Town Hall acoustics upgrades - $2.5 million. ► Capital renewals programmes	► Small to medium scale ► Renewal / refurbishment of existing assets over long term (potential to link capital and maintenance requirements) ► Interface risk – ongoing operations	► Competitive tender process encouraging cost efficiencies ► A team approach, with private sector expertise / experience harnessed early, creating opportunity for innovation ► Appropriate risk allocation - risks allocated to the party best able to manage them ► Demand risk transfer and user pays possibilities
Regional and local parks services Includes: ► Parks policy and acquisition ► Maintenance of regional parks, volcanic cones and Botanic gardens ► Provision and maintenance of local parks, reserves, sports parks and beaches including ► Performance measures include customer satisfaction and maintenance standards	► Significant land acquisition	► Simple purchase	► None identified
	► Development of sports field capacity ► Small scale development and renewals ► Significant local parks services projects	► Long term programme of small scale capital expenditure ► Potential to bundle works ► Asset renewals but limited operations – minor interface issues ► Long term maintenance requirement ► Requirement for supply chain management	► Access to private sector experience and expertise, creating opportunity for innovation ► Linking of payment to performance measures ► Potential to drive efficiencies through economies of scale / performance improvement over time (through repeat nature of work / use of standard designs)
Regional and local recreation services Includes: ► Recreation policy and initiatives ► Recreation facilities (swimming pools , recreation and leisure centres)	► Development of new recreation facilities	► Long term programme of small to medium scale capital expenditure ► Long term service requirement (potential to link capital, maintenance and operating requirements) ► Potential for innovation ► Potential to bundle projects (including renewals projects below) ►	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Linking of payment to performance measures ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Competitive tender process encouraging operational efficiencies ► Potential to drive efficiencies through economies of scale / performance improvement over time (through repeat nature of work / use of standard designs) ► Potential to include renewals projects below
	► Small scale redevelopment and renewals of	► Small to medium scale	► Competitive tender process encouraging cost

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
	existing facilities	▸ Renewal / refurbishment of existing assets and systems (potential to link capital and maintenance requirements) ▸ Interface risk – existing assets and ongoing operations	efficiencies ▸ A team approach, with private sector expertise / experience harnessed early, creating opportunity for innovation ▸ Appropriate risk allocation - risks allocated to the party best able to manage them
Regional collections and amenities Including public exhibition programmes, retail and other commercial services and support services	▸ Zoo facilities and services renewals (including exhibits and enclosure renewals) - $34.2 million	▸ Small to medium scale ▸ Renewal / refurbishment of existing assets and systems ▸ Interface risk – existing assets and ongoing operations	▸ Small – not considered
Stormwater and flood protection			
Stormwater management, flood protection and control services Includes: ▸ Managing storm water network ▸ Discharge consents ▸ Storm water incident response ▸ Public health and safety associated with the public storm water network ▸ Flood protection, incident response Performance measures include: ▸ Customer satisfaction ▸ Response times ▸ Storm water blockages ▸ Storm water consent conditions ▸ Habitable floors below flood plain ▸ Flood hazard mapping	▸ Network planning and storm water catchment - $604 million ▸ Storm water operations and maintenance - $164 million. ▸ Development of new regional programme of monitoring storm water asset ▸ Flood Alleviation Programme – up to $205.8 million	▸ Long term programme of capital and operating expenditure ▸ Long term service requirement ▸ Potential for innovation ▸ Interface risk – existing assets and ongoing operations	▸ Specification of requirements as outputs / outcomes ▸ Access to private sector experience and expertise, creating opportunity for innovation ▸ Linking of payment to performance measures (for example, achievement of environmental standards and flood protection requirements) ▸ Appropriate risk transfer, in particular design, construction, whole of life cost risk ▸ Competitive tender process encouraging operational efficiencies ▸ Potential to drive efficiencies through economies of scale / performance improvement over time ▸ Access to private sector finance
Corporate support			
Delivering organisational support which assists the operational functioning of day-to-day activities and including back office support. Performance measures include brand awareness, customer satisfaction, response times, financial governance, HR and organisational leadership	▸ Strategic property acquisition of $105.1 million to enable long-term savings	▸ Medium to large scale ▸ Long term service requirement ▸ Potential for innovation ▸ Up front funding requirement	▸ Specification of requirements as outputs / outcomes ▸ Access to private sector experience and expertise, creating opportunity for innovation ▸ Spreading of payments ▸ Linking of payment to performance measures ▸ Access to private sector finance ▸ Competitive tender process encouraging operational efficiencies

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
	► Implementing business processes and systems, and ongoing reviews of its operations in the drive for efficiency and cost savings	► Renewal and replacement of existing assets and systems ► Interface risk – existing assets and ongoing operations ► High technology risk	► None identified
Economic development			
Regional economic strategy and initiatives Includes developing partnerships and networks between Government and the private sector, and providing economic analysis and advice	► City transformational projects such as the City Centre Master Plan - $150.6 million, New Lynn regeneration project - $13.0 million, and Town Square Massey North - $7.0 million	► Long term programme of capital and operating expenditure ► Long term service requirement ► Potential for innovation ► Interface risk – existing assets and ongoing operations ► Requirement for supply chain management	► Competitive tender process encouraging cost efficiencies ► A team approach, with private sector expertise / experience harnessed early, creating opportunity for innovation ► Appropriate risk allocation - risks allocated to the party best able to manage them ► Specification of requirements as outputs / outcomes ► Linking of payment to performance measures ► Potential to drive efficiencies through economies of scale / performance improvement over time ► Access to private sector finance
	► The NZ Innovation Centre and national science and technology park adjacent to The University of Auckland's Tamaki campus - $27.8 million	► Small scale developments with limited commercial opportunities	► Small – not considered
Local economic development Includes local economic development, the delivery of Business Improvement District programmes and upgrading / maintaining the street environment and town centres	► Town centre and streetscape revitalisation and upgrades	► Small to medium scale ► Renewal / refurbishment of existing assets and systems ► Interface risk – existing assets and ongoing operations	► Assumed small – not considered
Tourism, major events and industry development Includes business / sector development, major events, tourism, visitor centres	► No major capital expenditure	► Assumed small – not considered	► Assumed small – not considered
Waterfront development To deliver the initiatives set out in the Waterfront Plan	► Cruise ship facility at Queen's Wharf - $11.6 million ► Light rail tram extension (Wynyard Quarter to Voyager Maritime Museum) - $8.3 million ► Marina - $21.8 million ► Wynyard Point Heritage Yacht Basin - $29.2 million ► Innovation precinct - $13.6 million	► Large scale and potential scope, with mixed use ► Long term service requirement ► Potential for innovation ► Significant up front funding requirement ► Commercial opportunities ► Outcomes optimised by Council ensuring high and consistent quality across the area	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Spreading of payments ► Linking of payment to performance measures ► Appropriate risk transfer, in particular design, construction, whole of life cost risk

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
	► Investment in Wynyard Quarter - $195 million		► Access to private sector finance ► Competitive tender process encouraging operational efficiencies ► Appointment of strategic partner based on alignment of goals and culture to drive long term value and outcomes
Other			
Governance			
Decision making and policy setting, including conduct of elections, mayoral office functions, monitoring of CCO's and regional governance / democracy	► No major capital expenditure	► Assumed small – not considered	► Assumed small – not considered
Planning			
Planning and transport strategy	► No major capital expenditure	► Assumed small – not considered	► Assumed small – not considered
Commercial and investment			
Commercial Investment in commercial property, city parks service, vehicle testing stations, holiday parks and other commercial activities	► Hobsonville Marine Precinct development - $45.5 million	► Small to medium ► Long term service requirement ► Potential for innovation ► Up front funding requirement ► Possible commercial opportunities	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Linking of payment to performance measures ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Competitive tender process encouraging operational efficiencies
	► Smaller scale development / redevelopment of town centres ► Renewals and maintenance of existing assets (incorporating holiday parks and commercial properties) -$29.5 million	► Small scale ► Renewal / refurbishment of existing assets ► Interface risk – existing assets and ongoing operations	► Competitive tender process encouraging cost efficiencies ► A team approach, with private sector expertise / experience harnessed early, creating opportunity for innovation ► Appropriate risk allocation - risks allocated to the party best able to manage them
Investment Management of major shareholdings including: ► POAL - 100 per cent owned ► AIAL - 22.4 per cent owned ► AFSL - 100 per cent owned	► Growth and renewals at Ports of Auckland	► Long term programme of renewal / refurbishment of existing assets ► Long term service requirement ► Potential for innovation ► Interface risk – existing assets and ongoing operations	► A team approach, with private sector expertise / experience harnessed early, creating opportunity for innovation ► Specification of requirements as outputs / outcomes ► Linking of payment to performance measures ► Appropriate risk allocation - risks allocated to the party best able to manage them

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
			► Competitive tender process encouraging operational efficiencies ► Potential to drive efficiencies through economies of scale / performance improvement over time ► Access to private sector finance
Built and natural environment			
Environment and heritage protection Ensuring natural and built environments are protected, including: ► Air, land and water monitoring and management ► Urban design ► Cultural and built heritage protection ► Natural heritage protection ► Environmental strategy	► Development of Historic Heritage Plan and Built Heritage Acquisition Fund - $33 million	► Simple purchase	► None identified
	► Closed landfill remediation to minimise threat from pollutants - $28 million	► Small scale	► Small - not considered
Local built and natural environment Local environment and heritage protection including wetland / habitat restoration and native planting	► No major capital expenditure	► Assumed small – not considered	► Assumed small – not considered
Regulation Includes Building and Resource Consents, land / property information, environmental health and licensing, animal control, marine safety and weather tightness	► No major capital expenditure	► Assumed small – not considered	► Assumed small – not considered
Solid Waste			
Waste and recycling services Includes recycling and waste collection and disposal	► No major capital expenditure	► Assumed small – not considered	► Assumed small – not considered
Community			
Cemeteries and crematoria Provide for burials, manage and control cemeteries, govern the management of cremations, and keep records and fulfil other administrative matters.	► No major capital expenditure. $19.6 million on maintaining and expanding regional cemeteries	► Assumed small – not considered	► Assumed small – not considered
Emergency management Responsible for ensuring effective responses to any civil defence emergency, managing	► No major capital expenditure	► Assumed small – not considered	► Assumed small – not considered

Services, responsibilities and performance measures	Key capital projects	Key project characteristics	PPP attributes that could be applied
unanticipated natural and manmade events and for the rural fire service			
Regional and local library services Responsible for local library facilities and services and for strategy and policy, including the need for and location of new libraries, collection policy and practice, service standards, and library exhibitions, programmes and events. Performance measures: ► Customer satisfaction ► Number of library visits ► Library building floor space	► Library collection renewals - $149.2 million	► Simple purchase	► None identified
	► Heritage material digitisation, libraries technology and libraries' online presence - $31.5 million (covering all capex work in digital space)	► Small scale ► Ongoing service requirement ► High technology risk	► Competitive tender process encouraging cost efficiencies ► A team approach, with private sector expertise / experience harnessed early, creating opportunity for innovation ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Linking of payment to performance measures
	► Capital projects ranging from minor refits of library facilities to major new or upgraded libraries in Waiheke, Massey North Flat Bush, Otahuhu, Ranui, Takanini, Highland Park, Devonport and Te Atatu Peninsula - up to $122 million	► Long term programme of small to medium scale capital expenditure ► Potential to bundle projects ► Long term service requirement (potential to link capital, maintenance and operations) ► Potential for innovation ► Interface risk – asset renewals only	► Specification of requirements as outputs / outcomes ► Access to private sector experience and expertise, creating opportunity for innovation ► Linking of payment to performance measures ► Appropriate risk transfer, in particular design, construction, whole of life cost risk ► Competitive tender process encouraging operational efficiencies ► Potential to drive efficiencies through economies of scale / performance improvement over time (through repeat nature of work / use of standard designs) ► Potential to include renewals projects ► Potential to include library services
Regional and local community services Include community development policy, community development initiatives, community facilities, safety programmes and social housing	► Redeveloping Wilsher Village - $37.7 million ► Renewing and developing housing for the elderly across Auckland - $15.9 million. ► Capital projects, mostly around upgrades of community centres and halls - $70.3 million	► Small scale ► Renewal / refurbishment of existing assets ► Interface risk – existing assets and ongoing operations	► Competitive tender process encouraging cost efficiencies ► A team approach, with private sector expertise / experience harnessed early, creating opportunity for innovation ► Appropriate risk allocation - risks allocated to the party best able to manage them

Key structural aspects

4. Key structural aspects of PPPs

4.1. Introduction

PPP procurement approaches can be technically complex with detailed risk allocations and complicated contractual structures involving specially formed Special Purpose Companies and multiple contractual arrangements. Nevertheless, these structures have become standardised for many PPP approaches, in particular the long term service contract (or DBFO / DBFM model) generally anticipated by Treasury when considering PPPs.

This section discusses the likely contractual structure and provides an overview of the risk allocation (and, in particular, the principles of the payment mechanism) under a PPP arrangement.

While Early Contractor Involvement models fall under the definition of PPPs, there are generally no significant differences between these approaches and traditional procurement in terms of risk allocation and contractual structure. Therefore, this section considers these key structural aspects of the DBFO / DBFM model only.

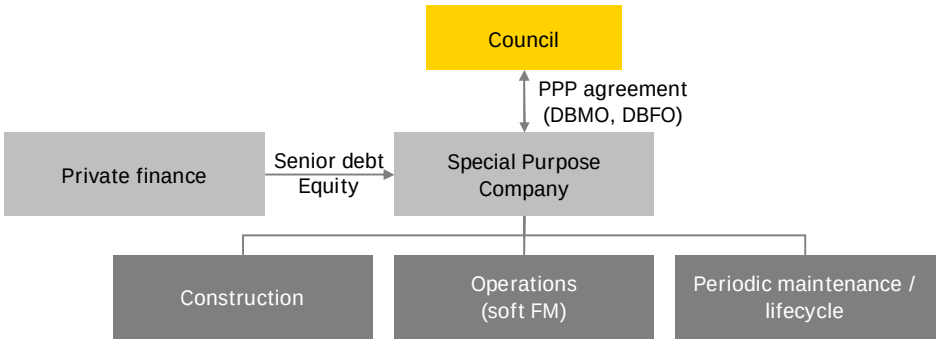
4.2. Contractual structure

The DBFO / DBFM model is a long term contractual arrangement that makes the private sector responsible for, and bear the risks of, designing, building, financing, maintaining and / or operating a public sector asset to output specifications set by the public sector. Under the availability based model, the public sector commits to make a unitary payment to the private sector for use of the maintained asset, once it is operational, over the life of the contract (typically 20 to 30 years).

The private sector generally establishes a new special purpose project company (SPC) to deliver the contract requirements. The contract between the public sector procuring authority and the private sector project company formalises the transfer of risk and the services required under the contract.

The SPC raises private finance to cover the costs of the project, and sub-contracts with third parties for the majority of its obligations (including the delivery of construction and facilities management services) required under the contract with the public sector. A contracting authority may contribute some of the capital funding requirement to the project, thereby reducing the amount of capital funding raised from the private sector, and ongoing project funding costs.

The likely contractual structure under a DBFO / DBFM approach is shown below.



DBFO / DBFM structures are usually highly geared, with around 80 to 90 per cent of the finance coming from debt and the remainder coming from equity. Debt finance typically covers the whole life of the contract, with increasing amounts being drawn down as the asset is constructed and then being paid off over the operational period. The cost of long term project borrowing can be fixed (either through fixed rate bank loans, or floating rate bank loans with long term interest rate swaps), or can be floating.

Debt for DBFO / DBFM projects is typically structured on a ring-fenced, project finance basis, and would be backed up by sub contractor parent company guarantees, to a specified amount.

Equity and subordinated loans are paid a return (as dividends and subordinated loan interest) from surplus project cashflows after all other project costs have been met. Equity carries a first loss position in the SPC (for

example, for performance penalties that reduce revenues or liabilities associated with asset ownership), and mitigates risks through insurance and through passing risks to sub-contractors.

In the event of default of the SPC, Auckland Council would be able to step into the sub-contracts through its direct agreements.

4.3. Risk allocation

Under traditional procurement approaches and, in general, collaborative construction based approaches, the majority of Project risks are retained by the public sector. A key characteristic of a DBFO / DBFM approach is a detailed risk allocation with risks allocated to those parties best able to manage them.

Reputational risk

Irrespective of procurement approach, Auckland Council is likely to retain reputational risk in respect of public infrastructure. This is because:

- the public sector tends to be perceived as being responsible for public infrastructure even where key risks (for example, design, construction and maintenance) have been assigned to the private sector (as would be the case under a DBFO / DFFM contract)
- ultimately, Auckland Council is responsible through the management of the PPP contract

The "standard" risk allocation adopted for DBFO / DBFM projects is shown in the table on the right. It is anticipated that this in a general sense would be deliverable, however, in shaping any contractual arrangements, Auckland Council would need to consider both the value for money implications and public perception of the final risk allocation.

In particular, treatment of the following key risks could impact on the attractiveness of a Project to third party investors and bespoke approaches may need to be developed and / or considered for specific projects.

Table 5 : Risk allocation matrix

Risk	Private Sector	Shared	AC
Construction (to time / budget)	✓		
Design quality	✓		
Lifecycle and maintenance	✓		
Insurance (operations)		✓	
Operational performance	✓		
Project management	✓		
Third party use		✓	
Demand risk / usage			✓

4.3.1. Demand risk

Demand risk has been historically difficult to transfer to the private sector under long term contracting arrangements. Whilst a private sector provider is able to ensure that an asset is available and well maintained, they have no control over whether the public use the asset. In particular, they have no control over other social and economic levers that may impact on demand. For example, for a public transport project, Auckland Council would have more control over influencing factors such as parking pricing and availability, the wider plan for Auckland and its impact on demographics, and alternative transport options. In addition, the public sector generally has a better understand of usage and demand data.

Demand risk is even higher for new infrastructure assets as there is no historic usage (data or actual) and therefore the private sector is being asked to take both the risk of uptake and continued demand.

The implications of transferring demand risk is highlighted though recent experience on greenfield toll roads where actual traffic volumes have been well below project sponsors financial forecasts. This has resulted in significant equity write downs (with investors in Australia alone losing approximately $3.7 billion) and a significant reduction in investor appetite for demand risk.

Due to these factors, it is generally not value for money to transfer demand risk.

4.3.2. Insurance

Depending on the size and location of a Project, given current seismic activity in NZ and the state of the insurance market, the placing and/or pricing whole of life fixed priced insurance (including reinstatement, for example, for earthquake damage) could still be problematic and may not be value for money. This risk can be mitigated through early engagement with insurance advisors to assess the scale of any issue and to develop a value for money risk sharing approach acceptable to Auckland Council, Treasury and bidders.

4.3.3. Asset ownership / residual value

In the majority of PPP projects, ownership of the assets remains with the public sector (assets are transferred back to the public sector for nil consideration at the end of the concession). However, there are examples of PPPs where assets have transferred to the private sector with the private sector taking residual value risk.

The key advantages of the private sector taking residual value risk are that:

- It improves affordability - where financiers are confident that assets have significant residual value at the end of a contract, they will be willing for a significant proportion of their finance to be repaid through a bullet repayment on the sale of the assets on expiry. The benefit to the public sector is that debt repayments are lower during the contract period reducing the overall Unitary Payment to the contractor.
- The public sector can walk away from the assets if it no longer requires them (although if the public sector requires the assets at contract expiry, it will need to pay for them).
- It drives up quality of design – this was a major and unanticipated benefit on a number of Defence Housing Executive (DHE) housing deals in the early 2000s (see breakout box).

However, this approach has a number of disadvantages and will only provide value for money in certain circumstances:

- Where assets have a specific purpose (for example, a hospital), there is no value in transferring the assets to the private sector as they have no other use. The contractor will assign no value to the assets but may in fact receive a windfall at contract expiry.
- If the public sector requires the assets at contract expiry, it will need to pay for them.
- Current funding markets and the state of the property market mean that preferential funding terms are unlikely to be achieved.

Case study 15 : Residual value: Defence Housing Executive (UK)

The Defence Housing Executive (DHE) in the UK entered into a number of PPP contracts for Defence housing in the early 2000s through which the residual value of the assets (i.e. the houses) was transferred to the private contractor. This generated a number of significant benefits to DHE:

- Design quality was significantly improved due to the need for the houses to be marketable
- The introduction of new and improved housing drove standards up across the estate
- The assets were removed from DHE's balance sheet
- The transfer of residual value risk improved affordability (see above)
- DHE was able to reduce its housing stock to meet reducing demand

4.3.4. Refinancing and effective base rate changes

Due to the debt tenors available in the NZ market, senior debt would need to be refinanced a number of times during the concession period of a DBFO / DBFM contract and the contractual arrangements will need to address this. The interest rate risk surrounding Effective Base Rate resetting was a significant issue in both NZ PPP's to date. As the PPP market evolves in New Zealand, it is likely that standard arrangements will be developed that are accepted by the funding market and are acceptable to both Auckland Council and Treasury.

4.4. Payment and performance mechanism

The payment mechanism is the single most important contractual interface between the public and private sectors in a PPP / Partnering project. It determines how much the contractor gets paid, and as such will influence contractor behaviour and, if correctly formulated, will drive value for money.

For the majority of PPPs, the payment mechanism will be an availability mechanism with payments from the public sector to the private sector partner made based on the 'availability' of the asset during specified time periods and performance against pre-determined standards. This is the approach used on the Wiri Prison and Hobsonville Schools PPPs in that the private sector assumes asset availability and performance risk.

The objectives of a payment mechanism should be to:

- Match payments with the outcomes or outputs Council wishes to be delivered
- Provide realistic, challenging but achievable performance standards
- Provide the contractor with the incentive to meet the performance standards, rectify problems through escalating deductions for worsening performance and to innovate and secure efficiency gains

The key features of an availability based payment mechanism are:

- The contractor receives no payment until assets are completed and services are available. This incentivises construction completion on time
- Deductions are made for non-availability of the assets and poor performance against specified performance indicators. Deductions should reflect the severity of failure, with rachets for prolonged or persistent failure
- Persistent poor performance leads to step-in and, ultimately, termination

Key to a successful payment mechanism is simplicity. It should be objective, transparent and easy to operate with performance standards that are measurable, recordable and reflect commercial reality. Council's need to tread the line between a mechanism that is sufficiently sophisticated to align with their objectives and one that retains enough simplicity to enable it to be communicated, applied and evaluated. Where payment mechanisms are overly complex, this can result in contractors including increased risk premiums due to uncertainty thereby eroding value for money.

What happens when PPPs go wrong?

It is often a misconception that the failure of a PPP results in significantly greater cost to the public sector. Even if the private sector partner becomes insolvent, a well structured PPP contract should protect the public sector from having to pay additional costs. In this case, either the lenders will step in and take over the operation of the facility so that they can continue to receive payment from the public sector, or the public sector will have the right to re-tender the project and pay a compensation payment (equal to the re-tender price) to the original contractor.

This protection of the public sector was borne out on the Australian toll roads and on the East Lothian schools and community facilities PFI in the UK where, following the insolvency of the lead contractor, the project was ultimately delivered to cost and equity investors absorbed the £10 to £12 million of additional "step-in" costs. However, there are extreme examples where the level of protection is inadequate (for example, Ararat Prison) which should ensure the public sector and its advisors remain vigilant at all times in structuring projects and evaluating tenders to ensure that risks taken by the private sector are being appropriately managed and laid off to companies with the financial resources to bear them.

Value for money and affordability

5. Value for money and affordability

5.1. Value for money

When considering PPP procurement options, as part of the Better Business Case guidelines, Treasury requires a value for money assessment to be undertaken to determine the optimal procurement option.

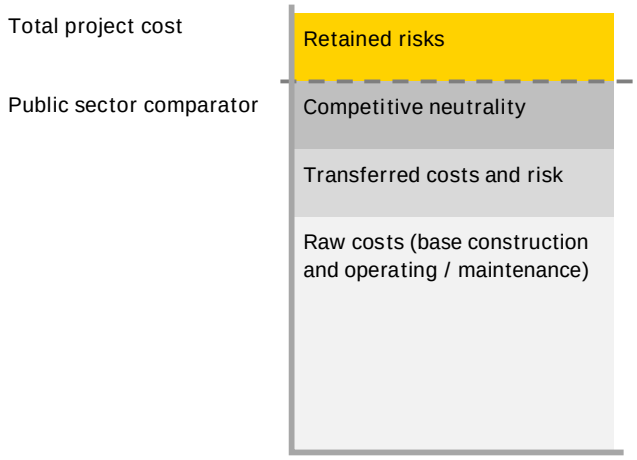
In assessing value for money, Auckland Council will be required to undertake both a quantitative and a qualitative assessment of procurement options to consider both the monetary and non-monetary costs and benefits of each option.

Costs and benefits are measured in net present value terms to take account of the time value of money. The net present value of each option is assessed against a public sector comparator (PSC) which is a measure of what the project would cost if delivered through traditional procurement.

The PSC is made up of:

- The construction and operating costs of a project, plus
- Provision for competitive neutrality adjustments to remove any advantages or disadvantages that accrue to a public sector procurer by virtue of its public ownership (for example, corporation tax paid by a private sector SPC that would not be paid under traditional procurement but which accrues to Government under a PPP option), plus
- Provision for any additional costs and risks that would be transferred to the private sector partner under a PPP. These risks need to be added as a cost to the PSC because the public sector party would bear the cost of any risks that occur under conventional procurement.

The concept of the PSC is illustrated in the diagram below. The dashed line represents the value of the PSC. It excludes the value of retained risks and costs because these are not passed to the private sector under the PPP and would therefore not be priced in a tender:



Further guidance is available at http://www.infrastructure.govt.nz/publications/pppguidance.

5.2. Affordability

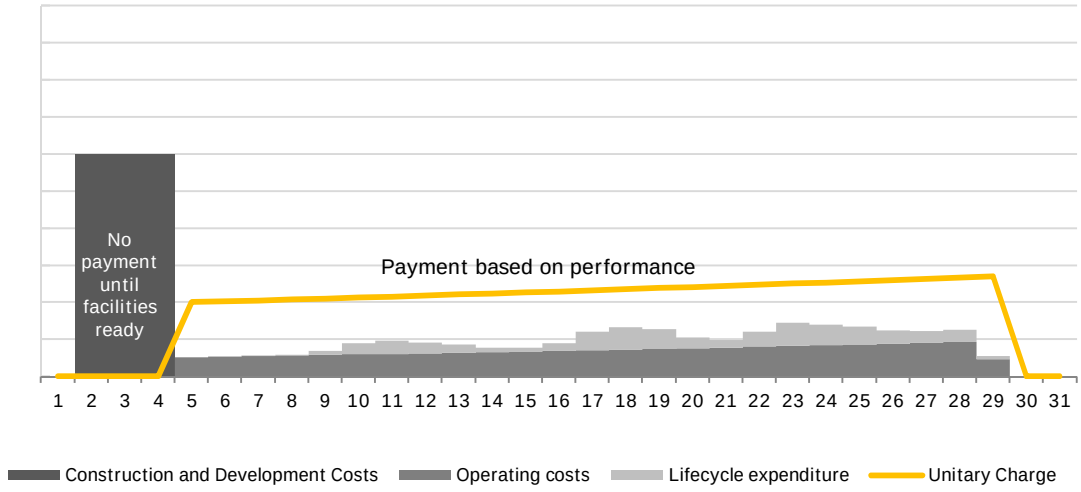
In addition to assessing whether a potential PPP represents value for money, Auckland Council will also need to ensure that the project is affordable on an annual basis.

One key difference between traditionally procured projects and those procured using PPP is the timing of payments from the public sector to the private sector. Under traditional procurement, the public sector pays the capital cost of the project upfront, followed by an ongoing amount for maintenance services over the life of the

asset. Under a DBFO / DBFM approach, the public sector does not pay for the project's capital costs over the construction period. Once the project is operational and is performing to the required standard, the public sector pays a unitary charge which includes payments for ongoing maintenance of the asset, as well as repayment of, and interest on, debt used to finance the capital costs. The unitary charge, therefore, represents the whole life cost associated with the asset.

The chart below provides an illustrative payment profile for a traditionally procured project compared to a unitary charge under a PPP project.

Diagram 6 : Payment profile - PPP vs traditional procurement



5.3. PPP balance sheet considerations

When considering the affordability of a Project, Auckland Council will need to consider the accounting treatment of the Project. In NZ, the public sector typically recognises PPP infrastructure as an asset on balance sheet.

The NZ IFRS guidance for PPP transactions generally falls under the NZ equivalent to International Financial Reporting Interpretations Committee Interpretation 12 Service Concession Arrangements (NZ IFRIC 12). However, NZ IFRIC 12 does not specifically address the accounting by the public sector "grantor" in an SCA. Typically, for a DBFO PPP, it is likely that the public sector would control the infrastructure asset and record on balance sheet, even though it has been constructed and may be legally "owned" by the private sector. Control for accounting purposes can be dictated through the regulation of services that the private sector operator must provide with the infrastructure, to whom it must provide them, and at what price, and through the ownership or beneficial entitlement of any significant residual interest in the infrastructure at the end of the term of the arrangement. The related liabilities and obligations in respect of the assets will also likely be recorded. This could result in the procuring body in effect "borrowing" to finance the asset (even though the private sector operator in the PPP borrows directly from third parties to finance the Project). This creates two possible issues:

1. The requirement for the procuring body to have "deemed"" borrowing powers in place in order to contract through on balance sheet PPPs

2. That borrowing could count against any indebtedness levels of the public sector entity.

In order for an infrastructure project to be assessed off balance sheet the full risks and benefits of the infrastructure would likely need to be transferred to the private sector operator, and the following apply in full or part

- The contract for the provision of the assets to be substantially shorter period than the structure's useful life

- The private operators finance is not 100% paid off during the contract period (and the operator requires other income to pay off its finance)

- The asset is “non specialist” to the extent that it may be used for a different purpose to that initially intended without substantial modification and it can be used for other purposes by the operator
- The operator has access to the asset for a period longer than the contract and the grantor relinquishes interests in the asset at the end of the contract

Whilst some of these areas could potentially be accommodated n project delivery structures, it would not normally be Value for Money and is not good practice to create artificial structures to implement the above to generate off balance sheet outcomes.

If undertaking PPP, potentially Auckland Council may have a twin budgetary impact from entering into a PPP whereby they account for and depreciate the full value of the asset from the outset as well as pay a capital and revenue element each year within the annual concession payment (made under DBFO). The impact of this accounting treatment on future maintenance and construction funding levels can be an issue if not fully understood and allowed for in long-term planning.

Changes to the statutory financial reporting framework

The NZ Government and the External Reporting Board (XRB) have proposed changes to the statutory financial reporting framework. Under the proposed financial reporting framework for Public Benefit Entities (PBEs), large and medium-sized entities in the PBE sector will be required to move to a new set of PBE standards, based on International Public Sector Accounting Standards (IPSAS). Large-sized PBEs (expenses over $30 million) would need to comply with the PBE standards in full with medium-sized PBEs (expenses between $2 million - $30 million) having reduced disclosure requirements.

The Government proposed changes to the statutory financial reporting framework were included in a Financial Reporting Amendment Bill, which was introduced into Parliament in 2012. The Government expects to enact the changes in 2013. Exposure drafts of the proposed PBE standards for public sector PBEs were issued in 2012, and the new PBE standards are expected to be issued in 2013 with a proposed effective date for public sector PBEs for financial years beginning on or after 1 July 2014, with early adoption not permitted. Within the exposure drafts of the proposed PBE standards was PBE IPSAS 32 Service Concession Arrangement: Grantor, which is intended to “mirror” the guidance in NZ IFRIC 12 (PBE FRS 45 under the proposed PBE standards). Thus, this is likely to result in similar accounting consequences to those identified above.

Other considerations

6. Other considerations

6.1. Procurement and project delivery timescales

Procurement regulations and requirements can severely impact both delivery timescales and costs, and the timeframes and costs associated with procuring a PPP project can be significant. This is highlighted in the table below which sets out the procurement timelines of the two New Zealand PPPs to have reached financial close to date and the anticipated timeline for the Transmission Gully roads PPP.

Table 6 : Projects timeline NZ PPPs

Milestone	Wiri Prison	Hobsonville Schools	Transmission Gully
Sponsor / Treasury IQA	October 2010	March 2011	Nov 2012
EOI released	Nov 2010 (4 responses)	April 2011 (5 responses)	Dec 2012 (5 responses)
RfP issued to shortlisted bidders	April 2011	June 2011	May 2013
RfP response	July 2011	Sept 2011	Oct 2013
Revise & confirm ("BaFo")	Dec 2011	-	-
Preferred bidder announcement	March 2012	March 2012	Jan 2014
Financial close	Sept 2012	April 2012	June 2014

These timelines exclude the time taken developing the project to the procurement stage which can be significant.

6.2. Pre procurement activities

An overview of the pre procurement activities that would need to be undertaken should Auckland Council wish to procure a project as a PPP is provided below:

Table 7 : Pre procurement activities

	Activity
AC	► Internal support and approval ► Confirm Project owner project management and governance
Client preparation	► Progress data room ► Communications with stakeholders ► Risk management register
Project team action	► Contractual delivery structure ► Legal, financial and technical specification and approach ► Procurement process and evaluation methodology
Client governance	► Update business case for final project scope ► Affordability ► Value for money assessment ► Procurement reviews ► Risk reviews

6.3. Mitigation

There are a number of ways in which the procurement timeframes (and transaction costs) could be mitigated.

- Standardised documentation – the use of a standard and accepted PPP contract, with minor changes to reflect the bespoke nature of a Project, will significantly reduce legal and due diligence costs, as well as procurement timeframes. As the New Zealand PPP market develops, standardised risk allocations are being developed and accepted and these can be drawn upon.

- Interactive procurement process – Concerns over probity have led the public sector in New Zealand to date to be cautious with regard the level of feedback they have provided to bidders during the procurement process. This has led to frustration for bidders as it has not been made sufficiently clear to them as to

whether their proposals are acceptable to the Client and meeting or even exceeding their expectations. Providing clear instructions and definitive feedback to bidders throughout the procurement process, with clear advice as to whether proposals are acceptable will improve the process, reduce abortive work and more closely align bidders' solutions to the public sector's requirements.

- Simplify submission requirements – The preparation / re-presentation of information in order to meet strict bid submission requirements can add significant time and cost to a bid. Procuring Authorities should consider carefully what information is strictly necessary in order to understand a bidder's proposals and assist with bid evaluation. The public sector should also endeavour to be more open to alternative presentations of information where this does not impact on the ability to evaluate a proposal. Once the nature and form of a Project is confirmed, submission requirements should be tailored, for example, to reflect the Project size and scope.

- Project management and governance - Because PPPs can be technically complex Projects, they require specific project governance and management procedures to make them successful, to minimise procurement time and cost and to maximise value for money.

6.4. Project management and governance

To be successful, to minimise procurement time and cost and to maximise value for money, proceeding with a PPP type approach requires absolute public sector commitment to the Project in terms of funding, objectives and procurement activities, including adequate Project resources and clearly defined Project governance, management and internal risk management procedures.

In order to take a Project forward, the following areas should be addressed:

- Experienced project delivery team – a dedicated, fully resourced and suitably experienced project delivery team and delivery office should be established with appropriate governance, communications and project management structures.

- Establishing approvals and value for money processes – the clear articulation of these processes will enable future transparency and audit-ability of investment decision making and provide a robust audit trail. They will also provide necessary confidence to stakeholder groups and potential bidders. These should be able to be developed to fit within current investment delivery processes.

- Stakeholder communication and management strategy – the early establishment of a Stakeholder Communications and Management Strategy which addresses key issues for stakeholder groups would promote engagement and will support key relationships which in turn will help ensure the successful delivery of a Project.

Local Government capability and appetite

There is currently little guidance on non-traditional procurement models tailored specifically to the local Government sector. Planning and developing major infrastructure projects is resource intensive and a lack of skilled personnel within local Government can be a considerable barrier. Furthermore, a cycle of poor understanding can lead to the propagation of myth around the perceived dangers of more complex models.

There can also be reluctance on the part of Councils to transfer risk and responsibility for Council assets and services to third parties. This is often a cultural issue and revolves around perceptions of control.

Whilst Auckland Council has significant resources, it currently has limited experience or expertise of PPPs. Because PPPs can be technically complex Projects, Council will need to develop and demonstrate an enhanced ability to undertake due diligence and procurement options analysis at the business case development stage to enable of a robust analysis of whole of life risks and the procurement models best suited to mitigate them.

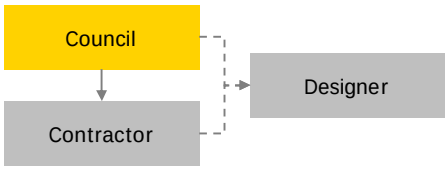
Appendices

Appendix A PPP procurement models

Collaborative construction based models

Early contractor involvement (ECI)

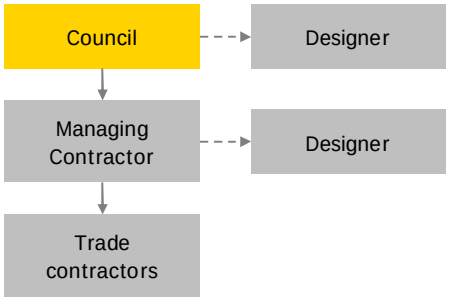
ECI is aimed at developing longer term relationships. ECI involve engaging the contractor during the early phases of a project to assist in the evolution of the design and to promote a better understanding by the parties of a project and its potential risks.



The benefit of ECI is that it utilises contractors' unique understanding of construction processes to optimise the design and delivery process. ECI involves the contractor far earlier in the process with the contractor joining the team right at the start and being involved with planning, assessing buildability, cost estimating and value engineering.

Managing Contractor

Under a Managing Contractor arrangement, Council engages a Managing Contractor who contracts directly with the designer and subcontractors to deliver a project. The Managing Contractor is engaged on a fixed management fee which is usually tendered on a competitive basis, and is appointed early to monitor the project from tender to design to completion.



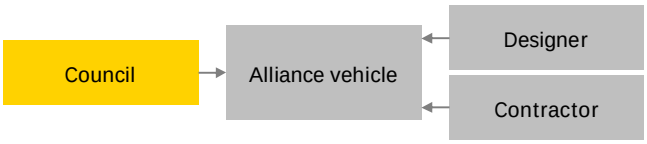
The model is flexible in that the Managing Contractor can be engaged to deliver a functional design brief prepared by Council or is fully responsible for the design and delivery of the project.

The Managing Contractor, although collaborating with Council, is ultimately responsible for the preparation of trade package documentation and the selection of tenderers and suppliers. The engagement of trade / design packages is open book and usually to a target sum. The Managing Contractor assumes some documentation and quality risk and is responsible for ensuring completion of the works by the date for practical completion.

The Managing Contractor is remunerated by a lump sum management fee, and receives incentives for managing the project within time and cost targets, however, any cost overrun risk is born by Government.

Alliance

Alliance contracting is a form of procurement where Council and other commercial participants (designers, contractors and key suppliers) collaborate to share in the risks and benefits of a construction project by entering into one contractual agreement, which encourages a “no blame” approach for issues and instead seeks to foster a “solutions” based culture.



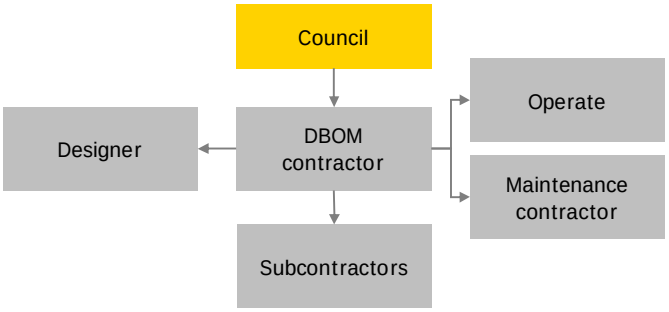
Under an alliance, the aim is to align the participants' objectives to maximise performance, proactively manage risk, reduce time and cost and achieve outstanding performance through innovative solutions. The alliance participants collaborate to develop time and cost targets during the pre-construction phase, and non-owner parties (participants other than Council) receive open-book reimbursement of direct project costs. The gain share/pain share payment structure is linked to the “Target Out-turn Cost”. This approach allows for progressive design and construction of some elements before others.

Long term service contracts

Design, Build, Operate and Maintain (DBOM)

The DBOM model is like a design and construct model except, as the name suggests, it also includes operational and maintenance activities for a specified period post completion of the construction phase, following which the operation of the asset is transferred back to Council.

Under this approach, Council prepares a detailed design brief and engages a single contractor (typically a consortium) to design, construct, operate and maintain the asset. The contractor is primarily responsible for associated design, construction and operation risks.

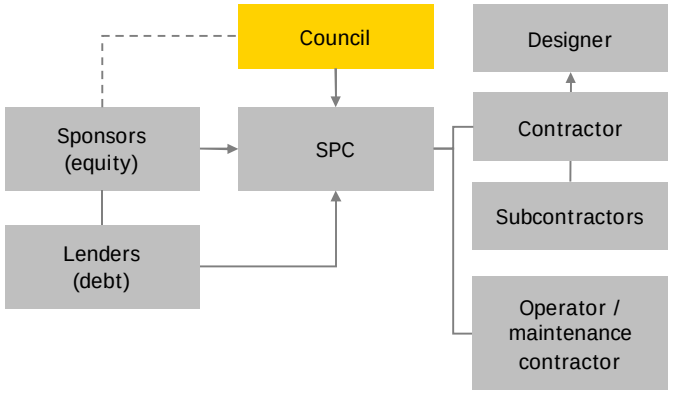


The DBOM contractor does not own the asset, but is contractually licensed to enter, operate and maintain it for a specified period. Typically, Council funds the project without a contribution from the DBOM contractor. A variant of this model is the DBM (Design, Build Maintain) whereby the contractor does not operate the asset post-construction. The contractor does however, provide maintenance services for a specified period.

Design, Build, Finance and Maintain (DBFM), Design, Build, Finance and Operate (DBFO) and Build, Own, Operate and Transfer (BOOT)

Under the DBFM/DBFO model, Council defines its requirements in an output specification and then enters into a contract with a special purpose company (SPC) to design and maintain and/or operate the asset for a specified period. A key differentiating factor of this model is that the private sector finances the project through sponsor equity and debt finance via the SPC.

Typically, Council retains ownership of the asset and grants rights to the SPC under a long-term lease or licence arrangement. The operation/maintenance period may be as short as 10 years, but is generally much longer (say 15 – 40 years) to enable the SPC to repay any financing and return profits to the sponsors. At the end of the lease/licence period, the asset is handed back to Council (with the SPC responsible for ensuring the condition of the asset meets certain hand back criteria) and Council takes over the operation/maintenance of the asset.



Under a full service model, in addition to providing soft FM services (for example, catering and cleaning), the private sector is also responsible for front line services (for example, clinical services or teaching).

Under the DBFM/DBFO model, Council is usually not required to make any upfront payment for the design or construction of the asset, and the SPC recovers these costs either:

i. by way of an availability charge or service fee payable by Council (availability PPP); or

ii. through the operation of the asset via the revenue stream generated by the asset such as usage charges (demand based PPP or user pays model).

Availability PPPs

Under an availability style PPP, demand risk is retained by the public sector. Unitary payments from the public sector to the private sector partner are made based on the 'availability' of the asset during specified time periods (and performance against pre-determined standards). In order to be deemed 'available', the asset must meet certain pre-determined availability criteria (for example, in relation to temperature, lighting and fixtures and fittings). Deductions are made for non-availability of the asset (and poor performance against pre-determined performance standards).

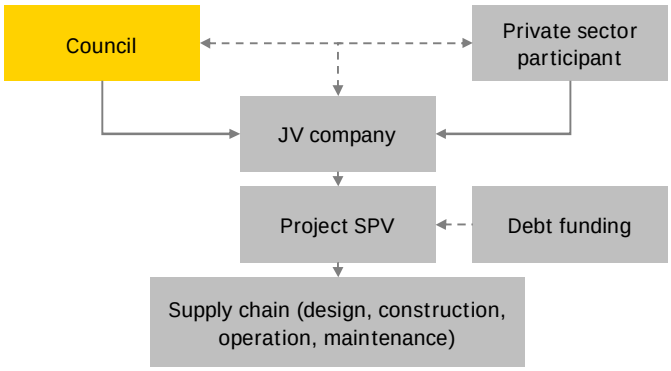
Demand based (or user pays) PPPs

Under a demand based PPP, demand and revenue risk is transferred to the private sector with the private sector charging users for the use of the facility, and with no direct public sector revenue guarantee. The private sector is reliant on users for revenue and therefore demand based PPPs represent higher risk to the private sector who are likely to require higher equity returns and debt margins than under an availability PPP. This model has been popular, for example, on toll roads in Australia, although there have been some significant failures where demand has not met expectations (see Section 2.4.2).

The BOOT model is similar to the DBFO model except that the SPV would own the asset during the specified operating period and then must transfer the completed asset back to Council. Like the DBFM/DBFO models, the operating period is usually long-term (15 – 40 years). Accordingly, until the asset is transferred back to Council at the end of the concession period, the SPV bears the risks associated with owning the asset.

Joint Ventures

Joint Ventures (JVs) are where both a public sector body and the private sector contribute to a commercial venture and agree to collaborate together to develop and manage that business on a joint basis and share the risks and benefits associated with the venture. Each party generally has an expertise or need which is central to the development and success of the new business which they decide to create together. It is also vital that the parties have a 'shared vision' about the objectives for the JV.

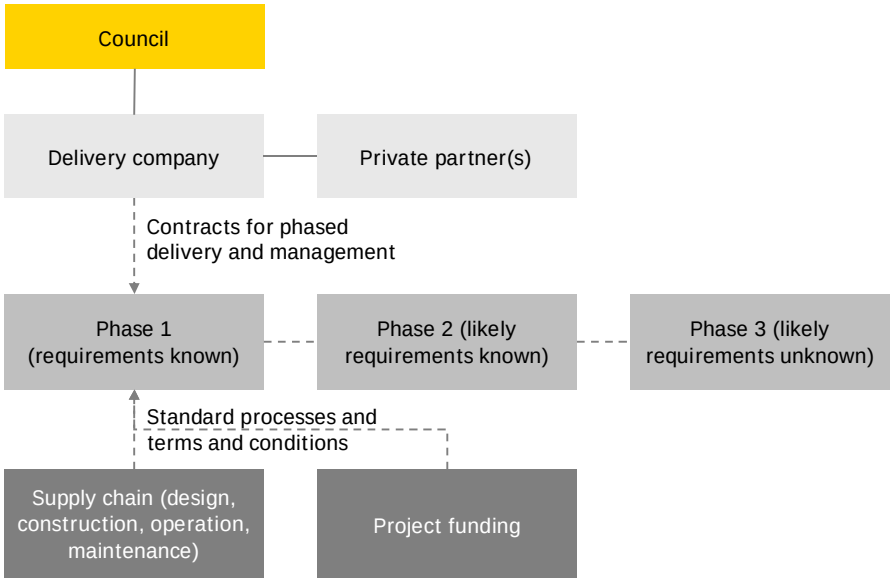


It is important to distinguish a JV from purely contractual arrangements where a public sector body gives a third party the right to provide services to the public in consideration of payment, for example, tolls payable to cross a bridge forming part of a public highway. A JV involves risk sharing and is typically used to:

- Embed partnership working, by bringing the public and private sectors together in an organisation where there is common purpose to work together, achieve the same outcomes and to combine what public and private sectors can best collectively contribute.
- Secure transparency of working, enabling effective benchmarking of performance, encouraging real trust to develop and generate long term Value for Money through constructive, collaborative engagement between public and private sectors.
- Incentivise both public and private sectors to achieve success together.

Long term partnering models

Strategic Partnering



Under a Strategic Partnering framework, a long term partnership is established between the public sector and its delivery partner (likely to be a specifically formed delivery company, which could include a Council ownership stake) to deliver a programme of known and unknown future projects and related asset management services.

Project delivery is facilitated through standard contracts, a standard risk allocation and standard procurement processes that the delivery company must work within in delivering each of the programme phases. All of these reflect accepted partnering precedents, and the standard contracts under which each phase is delivered could be for traditional procurement or may reflect ECI or long term service delivery models i.e the Strategic Partnership could be for a series of construction only contracts or, at the other extreme, a series of DBFO contracts or a mixture. While there may not be certainty over exactly what future phases will be, it is important to be able to give the market a realistic view as to the size and nature of the future workflow.

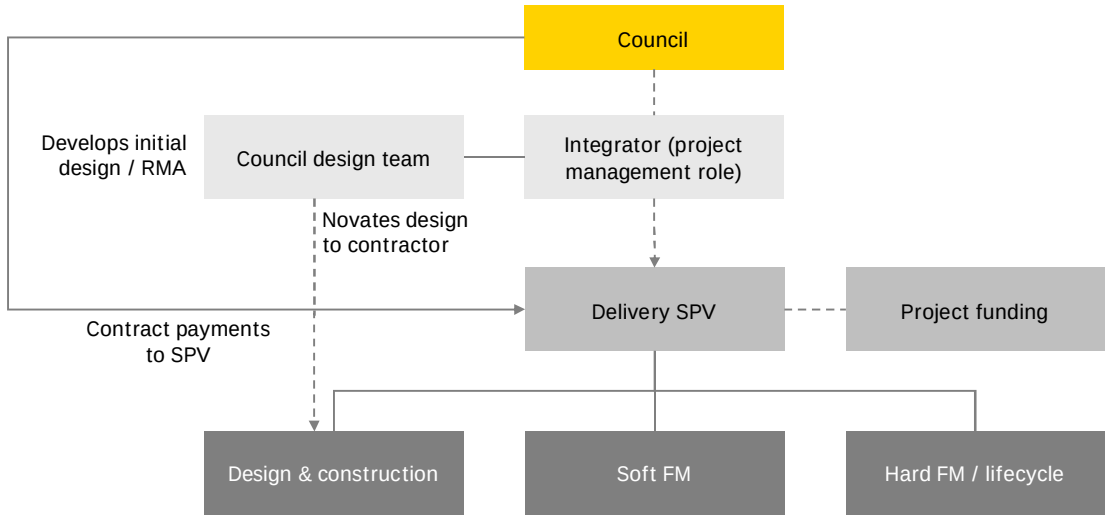
Typically, contractors are required to bid a fixed price for the first phase in the programme, and provide methodologies for taking forward future phases. The table below details specific measures to protect the public sector given the non competed nature of future project delivery.

Table 8 : Value for Money measures and justification – ongoing project delivery through appointed Strategic Partner

Tools	Description
Agreed standard process and approvals	► Used for bringing forward new projects covering technical, legal and financial requirements. These reduce ongoing procurement time and cost. ► Strategic Partnering Agreement requires ongoing assessment of performance and provision of a delivery plan through a partnering forum.
Value for money justification	► Qualitative and quantitative assessment applying national and local VfM guidance.
Benchmarking and market testing requirement	► Costed proposals compared against initial bid metrics and other comparable projects delivered on a similar basis elsewhere. ► Supply chains required to be competed underneath the partnering relationship therefore introducing contestability.
Payment mechanism	► Set contractual requirement to ensure appropriate performance levels.
Continuous improvement plans	► Requirement to improve quantitative and qualitative outputs over partnering period. ► Target cost reduction processes. ► Local processes still apply.
Skills	► Strategic planning skills from strategic partner likely to assist in determining best future profile of development.

If there is a phased programme of projects, such a model can deliver cost efficiencies and creates a long term partnering arrangement that can respond to a range of infrastructure needs in a measureable value for money manner over a significant time period.

Integrator



The Integrator Model (IM) is based on the appointment of a private sector partner (the Integrator) to develop and arrange delivery of identified infrastructure projects (and programme) on the client's behalf. The Integrator would co-ordinate the identification and formation of the delivery SPV under a competitive procedure.

- The Integrator may or may not be part of the design, construction, maintenance, operations elements of project delivery, and would not typically have a role in service provision. The Integrator would take a degree of project development and delivery risk.
- Once appointed through a formal Tender process, the Integrator would undertake to put in place the required delivery components of the project with the flexibility to use a range of procurement methods.
- The Integrator would be remunerated against measured outcomes and delivery success and would be penalised for time and cost over-runs, quality failures etc, particularly in respect of successful procurement completing activities.

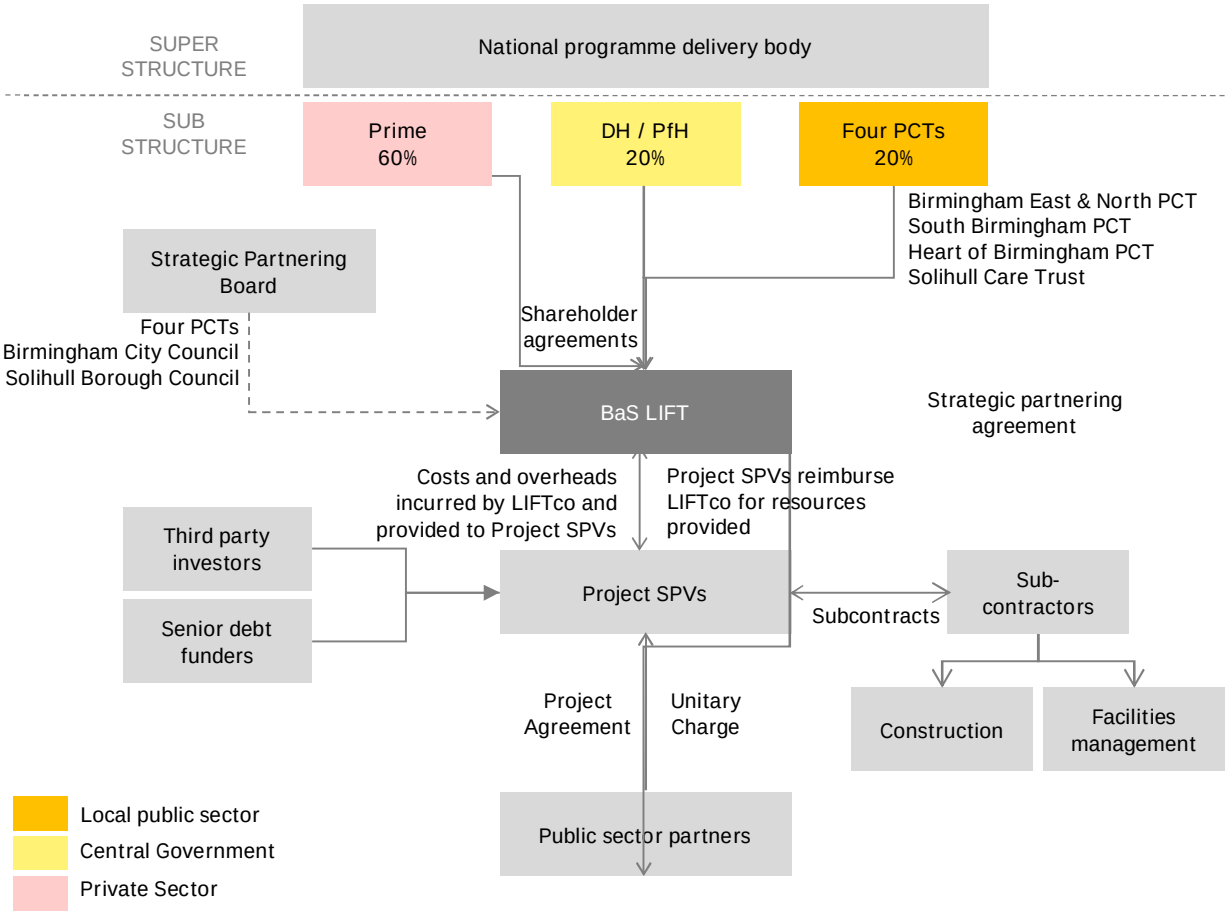
Appendix B Partnership models: Local Improvement Finance Trust (LIFT)

LIFT was introduced by the National Health Service (NHS) in the UK in 2000 as a private finance initiative (PFI) model for improving and developing frontline primary, community and social care facilities.

Through the LIFT process, a local primary care trust (PCT) - or a group of PCTs - engages a private sector partner to deliver a pipeline of projects. A streamlined procurement process is then used to deliver each facility through a two-staged approval process: business case with initial costing based on initial design followed by a fully costed proposal once design is agreed.

LIFT projects are delivered through the establishment of a "LIFTco" jointly owned by Partnerships for Health (PfH) acting on behalf of the Department of Health, the local PCT or PCTs, and a private sector partner. Contracts are typically for 25 years, to allow the LIFTco a guaranteed income stream to recoup development costs.

49 LIFTcos have been established to date, covering two thirds of England's population. They have delivered over £2.5bn of investment in more than 300 buildings that are either open or under construction. One example is BaS LIFT which is owned by four local PCTs, PfH, and Prime LIFT Investments Ltd (a company jointly owned by Prime Plc and Barclays Private Equity). It has completed 12 schemes to date, with a further 10 in development.



A key construct of the UK strategic partnering models is "national" programme management through a specially created body (the superstructure) established to roll out and oversee the programme, and local project delivery and asset management through specifically created corporate Joint Venture companies (BaS LIFT above) at the local delivery level (the sub structure).

The local delivery company (BaS LIFT) invests in commercially viable schemes, and raises debt and equity from the banking and private equity markets to fund construction costs. They then manage the build, operation and commissioning of the completed facility, for which they will receive a regular Unitary Payment or rental from the public sector parties (and potentially, in the case of retail / commercial developments, from third parties).

Initial procurement

An initial competition was run to find the private sector partner most capable of acting as co-shareholder with the public sector participant in the local delivery company and provide long-term partnering services. The first tranche of investments was identified, designed and priced as part of the original competition with methodologies to take forward future investments over time agreed as part of the initial procurement process.

Ongoing procurements

For each subsequent investment tranche that emerges, BaS LIFT is required to demonstrate that its proposals are VFM through a combination of tools that introduce the important element of contestability into the ongoing VFM process including:

- Supply chain competition
- Continuous improvement
- Benchmarking and market testing

Supporting tools are established to ensure that the cost data for projects is broken down and presented using a consistent methodology to allow proposals to be properly compared and benchmarked. Cost data is then compared against appropriate comparators, but also ensuring that a like for like comparison is made between different procurement routes, taking into account the differing content and varying responsibilities under alternative procurement routes. In Lift this includes District Valuer assessments of rentals paid by the public sector for accommodation space (on a cost per square meter basis) against public sector rental levels.

Other ways of ensuring ongoing VfM and performance of future project delivery are the concessions that are embedded in the standard processes e.g. the arrangements and requirements of the Strategic Partnering Agreement and oversight from the Strategic Partnering Board.

The operations and the programmes themselves cannot function on a sustainable basis without the following support structures:

- The Strategic Service Delivery Plan (Delivery Plan) – which sets out the planned capital developments over a five to ten year period. This plan is initially formulated as part of the local procurement partners business case and provides prospective deal-flow information to the private sector. In the partnering period, the Delivery Plan is reviewed, updated and signed off annually with new investment proposals (i.e. those not originally envisaged) captured in this process. The annual review of the Delivery Plan is also used as a monitoring tool and performance measure.
- The Strategic Partnering Board (or Forum) – the functions of the Strategic Partnering Board include the review of local company performance against the overall Delivery Plan. All participating public sector participants are represented on the Strategic Partnering Board as is the local delivery company. Additional roles of the Board are to provide guidance and confirm strategic appropriateness of new projects.
- The Strategic Partnering Agreement (SPA) - this is an agreement between the local delivery company and each of the participating local public sector bodies which forms and gives effect to the long term strategic partnering relationship between the company and each of the public sector parties. Under the SPA the local delivery company agrees to provide a range of estate management, estate planning and agreed associated services (“Partnering Services”) for those premises it develops and services.
- The Shareholders Agreement - regulates how the local delivery company is set up and managed, aligns interests of all stakeholders and reflects “typical” commercial Joint Venture arrangements. It is important to note that, notwithstanding the public sector stake, the local company management is able to act with private sector commercial freedoms to manage its business effectively.

Appendix C Auckland Council procurement policy

Overview of Auckland Council's current procurement policy

To ensure that the Council employs a standard approach to its procurement, Auckland Council has introduced a Procurement Policy. The purpose of this policy is to provide guidance to suppliers and staff of Auckland Council to achieve the outcomes of the procurement strategy. It defines how Auckland Council will undertake procurement decisions, and sets out the process of deciding who the Council should procure from.

The key objective of the procurement policy is that procurement will support the following six procurement principles in the Procurement Strategy:

- Work together - All procurement decisions will consider what is the most appropriate procurement option and be able to select from a range of delivery processes to facilitate the best outcome for council and the community.
- Value te Ao Maori - The procurement system will enable the integration of the Māori Responsiveness Framework in decision-making, business plan and procurement plan development, and service delivery to realise and enhance Auckland Council's commitment to Māori.
- Be Sustainable - Procurement practice supports the identification and assessment of social, environmental, cultural and economic interests of the community. This includes assessing, as well as possible, the impacts on current and future generations and communities.
- Act fairly – Procurement practice will demonstrate integrity by all parties, and enable all potential suppliers to have equal access through the use of open and contestable processes.
- Make the best use of every dollar - The procurement system will enable projects to identify and deliver on multiple outcomes for every dollar spent. Council will actively seek innovative approaches.
- Be affordable - Affordable in the procurement context means that the procurement process must efficiently identify and manage the criteria and weightings to ensure the appropriate balance between quality, and short and long term costs. In some circumstances, costs and benefits to be assessed would include economic, social and environmental and cultural costs and benefits.

Overview of Auckland Council's PPP policy

Auckland Council has introduced a policy to allow it to consider PPP as a procurement option and provide guidelines as to how PPPs should be assessed. This policy is set out at Chapter 15: Public private partnership policy of the LTP.

The policy recognises that a PPP can take a variety of forms but generally refers to the DBFO (or long term service contract) model. The focus of the policy is on large scale projects, typically infrastructure assets, and applies to significant partnerships only.

The policy sets out certain criteria (see below) that are required to be met in order for a PPP approach to be considered, however, under the policy Auckland Council is not obliged to enter into a partnership with the private sector even if one or more of these criteria are met.

Under the policy, every project that is considered for PPP procurement will need to be evaluated to determine the project's risk profile. The purpose of risk management is to determine if the risks present in the project can be allocated to the party (council or private sector) best able to manage them in an efficient and economic manner. Determination of this factor forms a key part of the evaluation of a project's suitability for PPP procurement.

PPP criteria

Under the policy, Auckland Council will only consider entering into a PPP if the following criteria are met:

- the partnership provides a higher quality and more cost-effective solution than alternative procurement options
- the proposal is being considered as an option within a broad procurement strategy, ie it is not a stand-alone consideration
- the partnership is of significant scale, with whole of life costs estimated at more than $50 million
- for availability based PPPs, council's desired outcomes can be well specified and linked to a performance evaluation framework that impacts on the remuneration received by the private sector.

In addition, consideration of a PPP as a procurement option will focus on whether:

- risks can be transferred to the partner best able to manage them
- the project presents an opportunity to provide certainty in regard to whole of life costs, by enabling prospective partners to present whole of life cost solutions for the provision of the asset and/or service
- the proposed contract addresses the needs of all stakeholders, and is not unnecessarily complex
- where there are more than two possible consortia interested in bidding for the project and at least two consortia who are committed to the project at tendering stage
- where the project presents opportunities for the private sector to earn third party revenues, these additional revenues should be compatible with the core service provided under the PPP contract
- there is scope, opportunity and incentive for innovative solutions to be achieved through the procurement of the contract
- there is adequate time to deliver the project
- the service required by council is not subject to large scale change over time, which could not be addressed within the context of a PPP.

Appendix D Case study: Mornington Peninsula Safer Local Roads program

Mornington Peninsula Shire Council has achieved substantial cost and service benefits through innovative procurement of maintenance, repair and capital works on its local road network – the Safer Local Roads program. Council adopted a non-traditional approach to managing local roads, using a Design Build Finance Maintain (DBFM) model to achieve savings of approximately $64 million over 15 years.

Mornington Peninsula Shire Council has an area of 723.1 km² and a population of 148,394 (ABS). It was established in 1994 following the amalgamation of the previous Shires of Flinders, Hastings and Mornington.

Shortly after amalgamation, council ceased to carry out any road infrastructure services in-house, opting for a 100% out-sourced delivery model. Works were planned and procured largely on an annual basis according to demand. Resealing, major patching, rehabilitation and reconstruction were procured under separate, short-term contracts.

Council found that this approach was not resulting in optimal outcomes for roads maintenance. In particular:

- The road network asset condition was in decline
- The approach to road network maintenance, repair and renewal was fragmented
- There was limited opportunity for innovation
- There was little integration between renewal and maintenance activities
- There was a focus on short-term planning to meet short term objectives - generally limited to 12 month periods – yet there were long-term performance risks
- Separate contracts were not cost effective or administratively efficient
- Short-term contracts led to frequent contract variations.

Following extensive consultation with the community and the Victorian Government, and the receipt of professional advice, council resolved to combine its annual expenditure on repair and maintenance contracts into a single road management contract for a 15 year period. The project included an integrated approach to planning and performing works and services in relation to:

- Routine road maintenance
- Periodic reseal/rehabilitation for roads, car parks and paths
- Maintenance and repair of stormwater pits and open drains
- Upgrading works
- Capital works.

Project delivery was based on what council describes as a partnership between a single private sector contractor and Mornington Peninsula Shire Council. The contractual arrangements took effect as a DBFM arrangement.

In order to determine whether delivering the project using a DBFM model would provide good value for money outcomes compared with the existing, traditional procurement of works and services for the local road network, council engaged consultants to prepare a Public Sector Comparator (PSC) at the procurement stage.

The PSC (which is typical for PPP procurements) estimated the net present cost to council of continuing with its existing arrangements, and was compared with the shortlisted submissions as part of the tender process. This exercise indicated that the existing procurement approach would result in costs of $203 million over the 15 year term, while contracting with the preferred tenderer would only cost $139 million, saving $64 million.

The analysis found that there were a number of advantages of the long-term DBFM approach. A single contract allowed council to stay within its allocated budget and provided for capital works, such as the construction of

new roads, which would otherwise have been impossible. In addition a long-term integrated contract would provide:

- Certainty in service delivery duration
- Savings in management / administration / plant costs
- Economies of scale
- Efficiencies in service delivery
- A reduction in longer term costs
- Greater innovation and added value.

The tendering process resulted in nine submissions, including some of the largest roads contractors in the market. Five submissions were subject to further evaluation and after an extensive process, the contract was awarded to Emoleum (which was subsequently acquired by Downer EDi). Unlike a typical DBFM model, the financing component of approximately $6 million was relatively small compared with the overall project value, and the contractor funded this on its balance sheet as opposed to arranging external financing.

The key elements of the contract are as follows.

Table 9 : Safer local roads – Key features

Service provider deliverables	► Maintenance and repair of 1,639 km of roads over 15 years ► $6 million of capital works to be completed in the first four years ► Council can also issue orders for additional works up to $100,000 ► Ongoing maintenance of asset condition from completion of accelerated program

Incentives/ performance	► Joint ownership of performance measures
	► Performance monitoring includes:
	  ► independent 3 yearly detailed assessment of council roads against “Payment Condition Index” (the service provider must either meet or exceed the index)
	  ► annual performance reviews including internal audit
	  ► annual customer satisfaction reviews
	  ► last resort contract termination
	► Independent auditor engaged to monitor and measure contract performance

Payment	► Council pays a smooth monthly service charge subject to adjustments for indexation, additional capital works ordered and additional works resulting from new roads coming under the council’s control ► The monthly service charge is subject to abatement for failure to perform or inadequate performance by the contractor ► While the payments are funded from ouncil’s general budget, any additional funds received from, for example, the Commonwealth’s Roads to Recovery program, are factored into the service provider’s schedule of works
Contract management	► The contract is managed by the senior representative team, services management team and an operations management team, comprising representatives of both parties ► The program of works is developed by the service provider, with the input of council

The Safer Local Roads program has now been running for five years, a third of the contract term. The following benefits can be identified.

Table 10 : Safer local roads – Key benefits

Outcomes	► Safer network, improved condition and appearance ► Innovation through long-term relationship ► Improved community satisfaction
Cost	► Higher project establishment costs with savings on procurement costs over 15 year term ► Smooth repayments establishing financial certainty ► Accelerated works program to achieve rapid improvements of identified areas, reducing whole-of-life costs
Certainty	► Certainty of works means that the renewals gap closed for 15 year period ► Minimal variations
Long-term added value	► Long-term added value and commitment from contractor to quality ► Whole-of-life consideration for all works leads to lower maintenance costs

	► Improved residual life and integration between renewal and maintenance ► Close council-contractor relationship allows flexible service delivery
Risk allocation	► Performance risk borne by contractor, any residual risk is shared ► Contractor takes more responsibility for quality under a long-term contract
Partnership	► Shared relationship based on trust encourages knowledge transfer and skill retention ► Ongoing onus on the parties to maintain shared communication

Council's commitment to innovation in this project has been recognised by two awards, IPWEA Australia (Vic) Excellence Award for Innovative Practice/Service Delivery and LGPA Award for Excellence – Services Delivery Initiative.

The success of this program can be attributed to the following:

- Commitment from council and willingness to transfer decision making to a third party
- Clear understanding of risk allocation, which was developed alongside the service provider following the selection of preferred tenderer
- Functional working partnership between council and the service provider
- Minimal disruption to existing contractual arrangements, in that roads maintenance had been out-sourced for some time (in councils where there are elements of in-house service delivery, the implementation of a similar program would likely result in issues surrounding employee transfer)

The Safer Local Roads program demonstrates how the bundling together infrastructure works over a significant area and time can create a program which is both attractive to the private sector, delivers innovation and partnership, and can ultimately provide value for money for local government.

The arrangement is especially suitable for network assets such as local roads. By way of example, Mornington Peninsula Shire investigated building upon the success of the Safer Local Roads program by implementing a similar arrangement for buildings maintenance and renewals, but concluded that the divergent characteristics of the different building classes rendered the project unsuitable for bundling. Council is currently funding academic research into ways of introducing bundled procurement in other areas – another indication of the potential council sees in this model.

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