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Value For Money in PPP Procurement

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Outline

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1. New South Wales, Australia
2. Procurement Options
3. PPP Framework
4. Public Sector Comparator
5. Benchmarking Studies
6. Post Implementation Reviews
7. Contract Management
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1. New South Wales, Australia

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Source: *Geoscience Australia,* www.ga.gov.au

Gross Domestic Product US$bn	
	2009
Spain	$1,438
Australia	$920
Netherlands	$790
Indonesia	$515
Sweden	$398
Norway	$369
New South Wales*	$367
Ireland	$227
Portugal	$220
Hong Kong SAR	$209
Singapore	$163
New Zealand	$110

Source: *International Monetary Fund, World Economic Outlook Database, October 2009*

* **Source:** *ABS Cat. No. 5220 Australian National Accounts: State Accounts ; AUD$/US$ = 0.9115*

2. Investment vs. Procurement Decision

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- Investment Decision – should we buy the Project?
  - Cost benefit analysis
  - Prioritisation within State Asset Acquisition Program
  - Projects must undergo standard investment appraisals and be approved and funded for conventional procurement, before a decision is taken to pursue PPP procurement

- Procurement Decision – what's the best way of buying?
  - Value for Money ('VFM') assessment based on <u>quality</u> and cost
  - Public interest evaluation, procurement plan, preliminary accounting treatment

2. Procurement Options

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Which method of procurement?

PPPs

- Large, complex and long term projects
- Capacity to allocate appropriate significant risk to the private sector
- Capacity to transfer significant non-core services to the private sector

Value For Money

- Design and Construction
- Operate and Maintain
- Alliance
- Build Own Operate
- Managing contractor

Traditional Procurement

2. Alliance (or Partnering) Contracting

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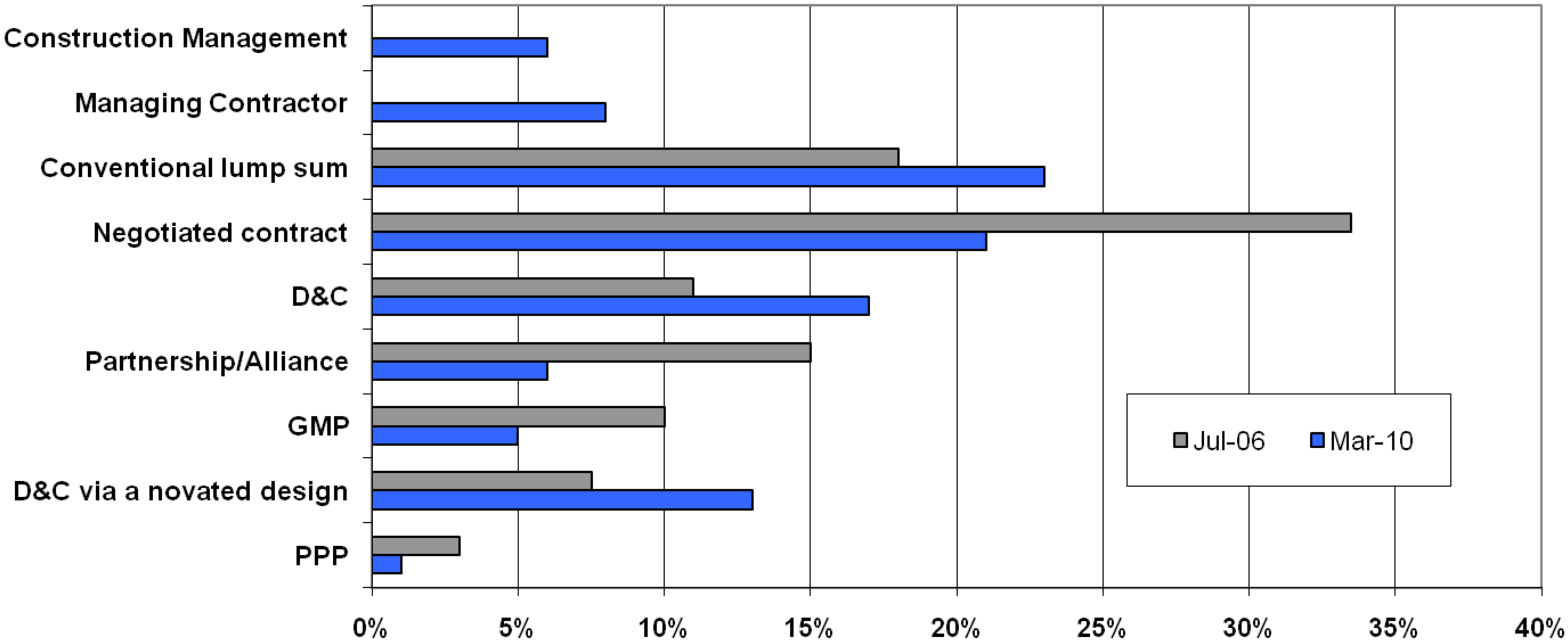
- Alliance contracting is a co-operative model characterised by openness, trust and an alignment of interests, and incorporates
  - risk sharing
  - no blame / no dispute / no legally binding contract
  - an alliance board, comprising representatives of the Government and contractor
- Most risks remain with the Government
- Contractors are likely to bid on projects because of lower liability exposures and guaranteed cost plus approach

2. Procurement Options

Procurement preferences of the Australian Construction Industry

"PPPs remain the least preferred procurement method…– reflecting the high cost of participation?"



Source: *Davis Langdon, Construction Sentiment, Findings Report 11, March 2010*

2. Procurement Options

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		Traditional Procurement			
	PPP	Design & Construct	Alliance / Partnering	Design, Construct, Maintain	Managing Contractor
• Time taken to Award Contract	✓	✓✓	✓✓✓	✓✓	✓✓✓
• Time to deliver the asset	✓✓✓	✓	✓✓	✓✓	✓✓
• Transaction costs	✓	✓✓	✓✓✓	✓✓	✓✓✓
• Cost Certainty	✓✓✓	✓	✓	✓✓✓	✓
• Whole of Life Maintenance	✓✓✓	x	x	✓✓✓	x
• Budget Certainty	✓✓✓	✓	✓	✓✓	✓
• Project Due diligence	✓✓✓	✓✓	✓	✓✓	✓
• Environmental Approvals	✓✓	✓✓✓	✓	✓✓	✓
• Change in Performance requirements	✓	x	x	✓	x
• Design Innovation	✓✓✓	✓	✓✓	✓✓	✓✓✓
• Construction Innovation	✓✓✓	✓✓	✓✓	✓✓✓	✓✓
• Commissioning/Decanting	✓✓✓	✓	✓	✓✓✓	✓✓

✓ Poor ✓✓✓ Good x Not Covered

2. Procurement Options:
Recent NSW Government Projects

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Sector	Project	Procurement
Transport	RailCorp Rolling Stock ($3.6bn) Pacific Highway upgrades (>$3.2bn)	PPP D&C, Alliance
Electricity	Colongra gas power station ($500m) and gas pipeline ($90m)	Power Station: D&C Pipeline: PPP
Water and Sewerage	Sydney Desalination Project ($1.9bn)	Plant: D&C, O&M Pipeline: Alliance
Health	Royal North Shore Hospital ($950m)	PPP

PFPs only account for around 10-15% of the State's capital expenditure. Government agencies tend to favour traditional procurement methods.

3. PPP Framework: PPP Policy

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- Value For Money ('VFM') is the Treasury objective
  - Public sector comparator: main VFM quantitative test
  - Other qualitative factors are also evaluated e.g. build quality, innovation in design, etc
- Risk transfer assists in achieving VFM, with risks being transferred to the party best capable of managing them
- PPP is only one of a number of procurement options – not used to achieve off-balance sheet financing

3. PPP Framework: Approval

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- *Public Authorities (Financial Arrangements) Act 1987* (NSW)

  - The PAFA Act contains the legislative basis through which the various arms of government are authorised to enter into PPP – i.e. a ‘Joint Financing Arrangement’ (‘JFA’)

  - Part 2B of the PAFA Act regulates JFAs, and section 20 gives a Public Authority the power to enter into a JFA:

    An authority may enter a joint financing arrangement, on the recommendation of the Minister for the authority, and with the written approval of the Treasurer specifically given in the case of each arrangement.

3. PPP Framework: Guidelines

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- The Council of Australian Governments (‘COAG’) agreed to new National PPP policy and guidelines for PPPs in November 2008
- The National policy and guidelines builds on NSW’s and Victoria’s existing PPP frameworks
- A suite of six policy documents have been developed, and are now effective across the country - they include:

Procurement Options Analysis	Public Sector Comparator Guidance
Practitioners’ Guide	Discount Rate Methodology Guidance
Commercial Principals for Social Infrastructure	Jurisdictional Requirements

4. Public Sector Comparator

- PPP project must demonstrate it will save money compared to a publicly financed alternative

- The policy framework mandates that a Public Sector Comparator (‘PSC’) is required to be developed

- Assessing the PPP bids against the PSC is a way of testing whether the PPP would provide better VFM than traditional procurement

4. Public Sector Comparator: Evaluation

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- The Net Present Cost (‘NPC’) of the risk adjusted PSC is compared to the NPC of the proposed future Service Fees paid to the bidder over the life of the PPP

- Two discount rates are used for the VFM evaluation in NSW:
  - The PSC is discounted at the risk-free rate (10 year yield on Government AAA bonds)
  - Bids are discounted using an ‘evaluation discount rate’, which is made up of the risk-free rate plus a margin for ‘systematic risk’ transferred to the private sector

4. The role of the PSC

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- The PSC will be:
  - subject to inherent limitations
  - accompanied by qualitative considerations in determining the potential VFM
  - subject to sensitivity testing and scenario analysis to determine the robustness of its underlying assumptions, and their impact on the PSCs results
  - flexible enough to allow new information to be incorporated as it comes to light, enhancing the integrity of the PSC as a benchmark

5. Benchmarking Studies

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- There have been a number of international studies which have sought to compare the performance of PPPs with traditional procurement
- Some studies have suffered from a number of methodological problems which may have biased results – problems include:
  - *Transparency*
  - *Population analysis*
  - *Representativeness of samples*
  - *Consistency and relevance of time period*
  - *Relative complexity selection bias*
  - *Measurement bias*
- There are inherent difficulties in in obtaining comparable data to make a complete comparison of PPPs with traditional procurement

References: Mott MacDonald *'Review of Large Public Procurement'* (2002), UK National Audit Office *'Performance of PFI Construction'* (2003)

5. Benchmarking Studies:
The Allen Report (2007)

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- Uses a research methodology designed to generate an objective set of data as developed by Melbourne University, using the National Forum database

- The study suggests that Australian PPP projects provide:
  - a high level of cost certainty
  - projects, and more importantly services, are being delivered as expected

Source: Allan Consulting, '*Performance of PPPs and Traditional Procurement in Australia*' (2007)
http://www.infrastructureaustralia.gov.au/public_private_partnership_related_reports.aspx

5. Benchmarking Studies:
The Allen Report (2007)

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- PPPs exhibit cost efficiency over traditional projects, which can range from 30.8 % when measured from project inception, to 11.4% when measured from contractual commitment to the final outcome:
  - PPPs were found to be completed 3.4% ahead of time on average, while traditional projects were completed 23.5% behind time
  - On a contracted \$4.9 billion of PPP projects the net cost over-run was only \$58 million, whereas the net cost overrun for \$4.5 billion of traditional procurement was \$673 million
  - PPP projects were far more transparent than traditional projects
- **Key conclusion:** PPPs provide superior performance in both the cost and time dimensions, and that the PPP advantage increases with the size and complexity of projects.

Source: Allan Consulting, '*Performance of PPPs and Traditional Procurement in Australia*' (2007)
http://www.infrastructureaustralia.gov.au/public_private_partnership_related_reports.aspx

5. Benchmarking Studies:
National PPP Forum (2008)

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- Initiated by the Australian National PPP Forum in 2005
- Melbourne University contracted to undertake the research
- Research methodology designed to address some of the deficiencies in other studies
- Compares capital costs between traditional and PPP procurement - whole of life costs for traditional projects were excluded from the study due to a lack of data
- **Key Findings:**
  - in meeting budgets, PPPs were 35.1% better than traditional procurement
  - post contractual close, PPPs had an average cost escalation of 4.3%, compared to 18% for traditional projects
  - during construction, the average PPP delay was 2.6%, while the average for traditional was 25.9%

Source: Colin Duffield, *'National PPP Forum - Benchmarking Study , Phase II' University of Melbourne, 2008*
http://www.infrastructureaustralia.gov.au/public_private_partnership_related_reports.aspx

5. Benchmarking Studies Alliancing:

In Pursuit of Additional Value (2009)

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- A study aimed at determining the rationale for the increased use of alliancing, and whether VFM could be enhanced
- Detailed benchmarking study of alliancing across Australia undertaken by Melbourne University, and investigates whether alliancing delivers incremental VFM against other forms of procurement
- Approximately 30% of all Australian State Government capital programs are delivered via alliancing
- The study found that the initial Total Outturn Cost (‘TOC’) estimates were 35-45% higher than the business case cost estimate. The final TOC on average increased 5-10% on the initial TOC
- The report indicated PPPs provide the greatest cost certainty at the business case stage, followed by traditional procurement, with alliancing providing the least cost certainty

5. Benchmarking Studies:
In Pursuit of Additional Value (2009)

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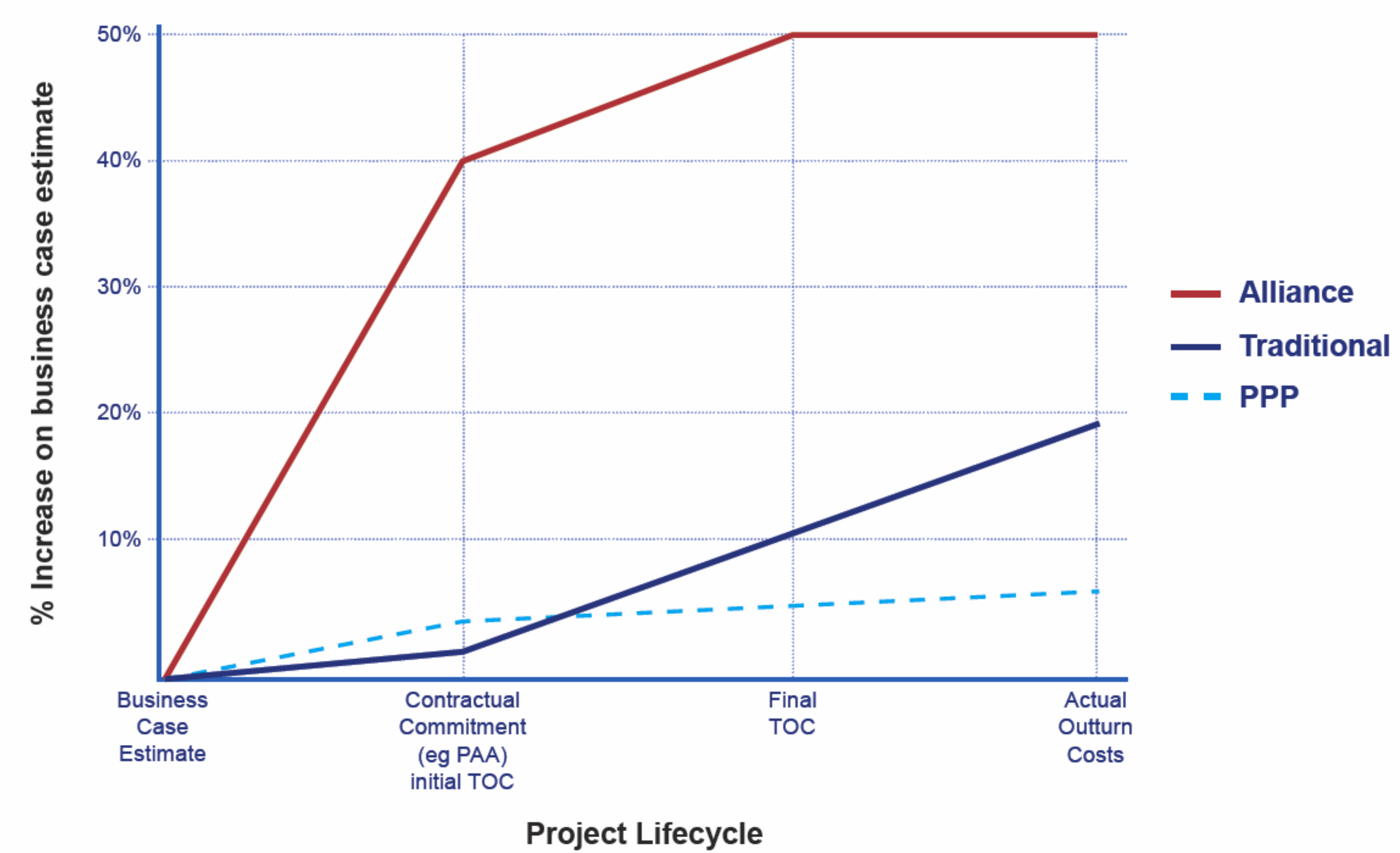

Source: DT&F, '*In Pursuit of Additional Value: a benchmarking study into additional value*' (2009)
http://www.nswprocurement.com.au/Government-Procurement-Frameworks/Construction/Framework/Project-Alliancing.aspx

6. Post Implementation Reviews

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- Post implementation reviews are required to be jointly carried out on each PPP by Treasury and the procuring agency
- Reviews are generally initiated 12 months after operations commence
- Service delivery performance and contractual compliance will be reviewed regularly throughout the life of the contract by the agency

7. Contract Management

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- VFM outcomes are contingent on effective contract management over the concession term
- Poor contract management can result in higher costs, wasted resources, impaired performance and public concern, hence PPPs require careful oversight and regular audits
- NSW Treasury hosts quarterly contract management working groups, where PPP contract managers discuss and share knowledge on current issues

8. Conclusion

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- PPPs are only entered where they provide the State VFM and are about 10% of the capital program
- Alliancing accounts for 30% of the capital program, having grown exponentially over the last 5 years
- The VFM assessment includes both, quantitative (e.g. PSC) and qualitative factors (e.g. build quality and innovation etc)
- Studies have shown that PPPs provide capital cost certainty, and on-time delivery
- VFM outcomes are contingent on effective contract management

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Questions?