

PUBLIC PRIVATE PARTNERSHIPS

OVERVIEW

Most jurisdictions in Australia, and many other countries, have developed or are currently developing policies and guidelines covering involvement by governments in Public Private Partnerships (PPPs). The prime objective of such policies and guidelines is to create a framework for possible PPP projects that ensures clarity and certainty for private sector participants and value for money for taxpayers.

In the Territory, the Department of the Chief Minister with assistance of other agencies including Treasury is currently developing a policy for Territory Government consideration. The draft policy paper is expected to be released for public consultation prior to the development of detailed guidelines necessary in the implementation phase. It is expected the policy will apply to all projects considered to be suitable for the PPP approach.

This chapter explains:

- what a PPP is and a government's associated objectives in moving towards the development of a PPP policy; and
- the key elements of a PPP framework.

WHAT IS A PUBLIC PRIVATE PARTNERSHIP?

A PPP can be described as a collaboration between the public and private sector to provide significant public infrastructure (or other facilities and services based on such infrastructure or facilities) premised on the allocation of risk to the party (either government or the private sector) best able to manage it. The development of a policy supporting a PPP arrangement provides a structured framework for the procurement of Government social and economic infrastructure.

PPP concepts can and have been used to apply to services other than those related solely to infrastructure although governments are generally moving away from such a broad application of the PPP approach.

There are a number of terms that have been used to describe such a collaboration between the public and private sector. These include Privately Financed Infrastructure (otherwise referred to as PFIs) or the Private Provision of Public Infrastructure.

The PPP framework involves government identifying an outcome it wishes to achieve through new or enhanced infrastructure investments, determining what role it will play and what role there is for the private sector in delivery of the outcome and then engaging in a process that determines whether private sector participation is the optimal way of delivering the desired outcome.

There are a number of reasons, including the significant legal and transactional costs involved in structuring a PPP arrangement, that mean that such an approach to delivery of government outcomes is not appropriate in all cases. In some instances, traditional procurement methods would be the more efficient approach.

PPPs are often said to be a method of obtaining greater levels of private sector investment in social and economic infrastructure. However, although sometimes avoiding up front capital costs, they should not be considered a means of providing short term financial improvements as governments are required to pay long term useage charges for

the infrastructure. If governments are able to reduce overall whole of life project costs by appropriate risk allocation and risk management arrangements, then a PPP could provide a viable alternative to more traditional forms of procurement or service provision.

An example of a traditional form of procurement is a construction-only contract where government approves a design for specific infrastructure then contracts with the private sector for its construction. The Government owns the infrastructure and is responsible for its ongoing operation including maintenance and related service costs. In simple terms, an application of the PPP framework could see the private sector designing, building, owning and operating the infrastructure with the government paying a service provision fee for use of the fully serviced and maintained infrastructure.

Governments are increasingly recognising that asset ownership with or without government operation is not necessarily crucial to service delivery. The private sector can be involved through financing, building and owning and/or operating the infrastructure identified by the government as being required. Ownership could transfer to the public sector at the end of a specified period or could be retained by the private sector.

PPPs can include long-term management of infrastructure but usually do not include provision of core services. Governments are generally held to be responsible for core services irrespective of their direct or indirect contractual obligations. In such circumstances, benefits of a PPP arrangement usually cannot be captured as it is difficult to achieve optimal risk allocation to the private sector.

In other jurisdictions, the PPP policy has been restricted to social and economic infrastructure projects only. However, many issues that necessarily must be addressed in any framework for PPP projects could reasonably have general application to outsourcing of services and privatisation.

The largest PPP project in Australia in 2001 was the Alice Springs to Darwin railway. The South Australian and Northern Territory Governments sought to link the two capital cities via a railway line. Both Governments agreed what role each would play (in financial and non-financial terms) in facilitating private sector involvement, then called for tenders for the private sector to build, own and operate the infrastructure for a defined period of time. The agreement involved establishing a special purpose corporation, which the Governments use as the main vehicle for participation in the project. The Governments then contracted with the successful consortium to effect the arrangement.

A PPP policy requires consideration of a number of key policy issues and these are listed in the Appendix to this Chapter.

THE PUBLIC PRIVATE PARTNERSHIP FRAMEWORK

Value for Money

The primary driver for governments in any method of procurement and in adopting a PPP approach to infrastructure and associated service delivery is 'value for money', in the context of the whole of the partnership's life. This therefore takes into account risk allocation and the quality of infrastructure and service delivery able to be achieved through procurement.

Decisions as to the method of delivery of government infrastructure take into account whole of life costs and should not necessarily presume that the private sector can operate more efficiently than the public sector. A PPP arrangement should only be contemplated where it is demonstrated that the private sector will add value, in both financial and non-financial terms, to delivery of government's pre-determined outcomes.

At the same time, a PPP approach also provides the framework and opportunity for access to greater levels of private sector investment in social and economic infrastructure.

One of the key elements of a successful PPP project is that the arrangement needs to be a commercially viable proposition for the private sector. This can be achieved where there are private sector efficiencies or synergies which can be shared with government or where the private sector is better placed to manage inherent project-related risks than government.

Generally, PPP arrangements are long-term arrangements which could span up to 30 years or more. These projects are often complex and resource intensive, with significant levels of financial commitment required at the front end of the process. This means that it is not financially viable for smaller scale projects to be structured as PPPs as set-up costs could outweigh any long term benefits achievable from a PPP arrangement.

Public Sector Comparator

In order to assess whether a PPP is the optimal solution, it is necessary to determine whether it provides the best value for money outcome. This is done through the development of a public sector comparator which is a critical element in the PPP framework. The public sector comparator provides the quantitative benchmark against which to measure the value for money of private sector proposals. The public sector comparator is a costing of the most efficient form of public sector delivery of the defined outcome expressed in net present value terms and recognises whole of life costs and risks associated with the project. The comparator needs to recognise competitive neutrality issues and the full costs of Government undertaking the same project as is being offered to the private sector.

As an example, governments characteristically can borrow at a lower cost than private sector companies, but the general view is this 'advantage' should be disregarded in the comparator to the extent that the cost of funds should reflect the project risk, rather than the government's credit strength.

Development of guidelines for the construction of a public sector comparator is an essential component of the Territory's proposed PPPs policy framework. The public sector comparator needs to be constructed in such a way as to correctly cost the risk borne by the public sector in the delivery of the infrastructure and service. Such appraisals are not often required when traditional procurement methods are used. Largely as a result, the public sector comparator is difficult to establish and requires substantial resources to ensure it is as accurate as possible. If the public sector comparator is not developed with sufficient rigour then the process will be flawed from the outset. This is regardless of whether a project proceeds as a public sector partnership or through traditional procurement methods as the public sector comparator will be used as the base against which actual costs can be compared over time. This comparison will be the basis of determining whether or not a project has been financially beneficial to a government over time.

As a general rule, a project in partnership with the private sector will not proceed unless whole of life costs (adjusted for risk assumption and including service standards) bid by the private sector are below those of the public sector comparator. Where bid costs adjusted for risk are higher, the public sector is in a position to deliver the specified outcomes more cheaply. In the absence of countervailing qualitative and policy considerations, a partnership with the private sector is not a viable option.

If private sector participation is sought but the process determines that the outcome is achieved better through the government delivering the outcome without private sector involvement, then the outcome should be delivered by government. The framework recognises the outcome is the key objective of the government and as such, the outcome should be delivered with or without PPP involvement.

Some other Australian jurisdictions advocate disclosure of the public sector comparator in tender documentation on the basis that such openness and transparency will assist in the competitive bidding process. However, it is acknowledged that it may not always be appropriate for the public sector comparator to be disclosed, especially where the bidding field is not strong or where there is a high level of industry knowledge.

Monetary Threshold

PPP projects are generally complex and resource intensive, in large part because of the very long term perspective required for whole of life considerations, but also because of the need to recognise risk and allocate it appropriately over the project's life. Transaction and legal costs involved in establishing these arrangements make projects at the lower end of the scale in terms of project size and cost less likely to be viable through application of the PPP framework. As such, other jurisdictions have not considered it appropriate that all infrastructure projects be regarded as necessarily part of the PPP framework.

Other Australian jurisdictions have monetary thresholds for potential PPP projects ranging from \$10 million to \$30 million in terms of whole of life costs. This means that payments made by the government or users (such as for toll roads) over the life of the project are included in the threshold rather than simply any up-front payments that may be required or the cost of the actual infrastructure itself without the service delivery component.

The Territory is in the process of considering an appropriate monetary threshold for the Territory framework which would need to balance the cost involved for the public and private sectors in establishing a PPP arrangement against projects of a scale sustainable by the Territory's relatively smaller economy and smaller businesses.

Performance and Contract Management

A significant and often, in the past, neglected stage of a PPP arrangement is the contract management phase. It is an essential, although time-consuming and potentially costly element, of a successful PPP. A number of jurisdictions have acknowledged that while there is significant consideration given to the tender, evaluation and contract negotiation areas of PPPs, significantly less attention has been paid to contract management. These skills have not previously been widespread in the public sector.

Once a PPP arrangement has been effected, Government's primary concern will be to ensure performance standards are achieved and that effective mechanisms are introduced to ensure delivery of ongoing value for money over the project life. While performance can be driven through appropriately structured performance incentives or disincentives, sound contract management arrangements are required to ensure performance standards meet and preferably exceed expectations all through the long contract life. Without them, what could have been a beneficial project for a government could quickly become instead a more costly exercise than if traditional procurement methods had been adopted.

CONCLUSION

Most other Australian jurisdictions have published or are in the process of developing PPP documentation that outlines their individual approaches to seeking interest in, evaluating and entering into associated contracts with the private sector.

PPPs are not a cost or risk free method of delivering needed infrastructure or services that require such infrastructure. However, PPPs can contribute to the expansion of public infrastructure in certain circumstances. Development of a sound PPP framework should assist the Territory in managing the delivery of infrastructure and associated services. This is because application of the framework should introduce discipline and consistent approaches from Territory agencies to the achievement of the Territory's objectives.

The private sector will also benefit from knowledge of the framework as the Government's processes and objectives will be better articulated and its outcomes specified at the outset of the procurement process. Private sector comment on the framework as a result will be a valuable input into finalisation of the Territory's PPPs policy.