

## **ROLE OF PPPS IN INFRASTRUCTURE PROVISION**

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**Address to Committee of Economic Development of Australia**

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# **The Role of Public Private Partnerships in Infrastructure Provision**

## **Introduction**

- Thank you for inviting me to speak at this luncheon.
- I have been asked to speak for around 20 minutes and am happy to take any questions you may have at the end.
- **Outline:**
  - Overview of infrastructure planning and demands on infrastructure
  - How PFPs fit into the picture and what PFPs bring to Government
  - Outcome of recent Inquiries and audits into PFPs
  - The Future of PFPs and the Challenges for the Private Sector

## **Infrastructure Planning and the Demands on Infrastructure**

- NSW Government capital expenditure is currently running at its highest level ever. Capital expenditure in 2005-06 is over \$8 billion, around 15% higher than 2004-05. And this high level of capital expenditure is expected to continue.
- Infrastructure requirements are driven by demands for government services and these in turn are mainly driven by
  - Population growth
  - Changing population distribution (geographically across the State)

- Ageing and increased longevity
- Infrastructure is also influenced by technological change.
 

Improvements in technology are especially evident in medical and ICT areas and their impact on the budgets of health, police, attorney general's and education is significant.
- Infrastructure costs have also been increasing due to strong market demand for infrastructure (both here and internationally) leading to a rise in construction costs.
- In addition, a large proportion of public infrastructure was built in the 1950s after World War II and now requires renewal. This is evident in some areas of the State in water, transport, electricity and public housing.

### **Infrastructure Financing and Funding**

- All infrastructure regardless of how it is financed must be consistent with the emerging needs and priorities of business and the community and in government is driven by the service objectives of agencies and the physical assets they need to meet these objectives.
- The main funding sources for government infrastructure are taxes, user charges and borrowings.

- When the Government borrows to finance infrastructure the principal and interest payments are ultimately serviced by tax revenues or user charges.
- In the General Government sector (health, education, police etc) there are very few user charges and borrowing costs are mainly met by tax revenues. For that reason it is current policy to limit borrowings in the General Government sector. All debt does in this situation is to move benefits to the present and pass costs to future taxpayers. The future taxpayers have less to spend on their essential services because of interest costs.
- On the other hand, in the Public Trading Enterprise sector (electricity, water etc) the funding source is predominantly user charges. In this sector, capital expenditure earns a regulated “commercial” return and prudent borrowing is appropriate.
- In 2005-06, net borrowings of \$2.6 billion will be used to finance \$8.2 billion in capital expenditure.
- Privately financing economic infrastructure like toll roads and water treatment plants can create an additional revenue source through user charges. These transactions are off-balance and do not require an on-going Budget funding commitment.

- In contrast, privately financing social infrastructure like, schools and hospitals etc, are paid for by taxes. Privately financing social infrastructure does not create an additional funding source. And these projects are carried on our balance sheet.

### **The Role of Privately Financed Projects and VFM**

- The Government only privately finances projects where they fit in with government objectives and plans and bring “value for money”.
- For both social and economic infrastructure, this means the projects must be part of agency requirements and the financing, design, construction and operations must be delivered in a cost effective and efficient manner that is better than what would occur if government provided these services.

### **Recent Inquiries:**

- There have been a number of recent and current inquiries and audits into privately financed projects.
  - Professor Richmond released his Motorways Review in December 2005
  - The Joint Select Committee Inquiry into the Cross-City Tunnel released their first report in February 2006.

- NSW Treasury released its Post Implementation Review of the first New Schools PFP in December 2005
- The Auditor-General released a performance audit of the New Schools Privately Financed Project in March 2006.
- It is expected that the Public Accounts Committee will release their report on their Inquiry into Public Private Partnerships in April 2006.

### **Outcomes of these Inquiries**

- Importantly, no finding or recommendation has suggested discontinuing the use of PFPs.
- The Inquiries have suggested refinements to the process in the areas of contractual disclosure, changes to the Working With Government Guidelines, checks and balances on the public interest test, public consultation and refinements to the tender process.
- The WWG Guidelines will therefore be amended to provide the following:
  - improved clarity and less ambiguity,
  - firming-up the public interest evaluation test and the requirements to consider this test prior to approval to proceed to EOI,

- including guidance on non-conforming proposals and the Best and Final Offer stage of a tender,
  - a clearer relationship between the new planning processes and the PFP approval processes
- Consistent with Inquiry recommendations, a revised Ministerial Memorandum governing public disclosure of Government contracts with the private sector will be issued in the near future.
- This Memorandum is expected to require, for privately financed projects:
  - publicly disclosing the full contract (excluding confidential information);
  - and disclosing material variations to the contracts.
- Consistent with this forthcoming Memorandum, the contract deed for the recently signed Newcastle Mater Hospital Redevelopment Privately Financed Project has been posted on the NSW Government Tenders website.
- The NSW Treasury Review on the first New Schools PFP also found:
  - The payment mechanism needed simplifying – this was achieved in the second New Schools PFP
  - A better balance was needed between strict probity compared with more bidder engagement to achieve greater understanding of the government's requirements. More Government and

bidder interaction occurred for New Schools 2, the Mater Redevelopment PFP and the Long Bay Forensic Hospital PFP. This helped to achieve a better outcome on these projects without compromising probity.

### **Challenges for the Private Sector**

- Future and current PFPs for social infrastructure are tending to increase the scope of privately provided services
- In appropriate circumstances, this can reduce project risks by minimizing the interface risks between publicly and privately provided services.
- For example,
  - For the Bonnyrigg public housing renewal project, the private sector will rely on a Non-Government Organisation to provide tenancy management services. These services include administration of landlord responsibilities, rent collection, re-housing and communication. This will achieve a more efficient allocation of risk given the potential for tenant needs and actions to affect the housing renewal and maintenance programs and vice versa. It will also facilitate a more collaborative relationship with other members of the consortium working on the project.



- The challenge for the private sector is to find appropriate and experienced service providers, including Non Government Organisations that can work well with them.
- A more co-operative approach with government and more effort by the private sector to understand the Government's requirements is needed with these developments.
- A co-operative environment was not achieved in the Port Macquarie Hospital PFP. Issues caused by changing medical technology coupled with a need to vary the contract, caused the PFP to run into difficulties. This led to the government acquiring the hospital last year.
- In contrast, the performance of the private contractor at Junee prison has been pleasing with services being well defined, appropriate performance indicators being set and met, and a co-operative approach taken with the Department of Corrective Services.
- **Brownfield sites**
  - There is currently a greater focus on brownfield sites with this being a feature of the Newcastle Mater Hospital PFP, the Long-Bay Forensic Hospital PFP and the Bonnyrigg public housing renewal project. This trend is likely to continue.
  - Brownfield sites introduce new challenges for the Government and the private sector in the areas of:

- latent condition risks of existing buildings
- maintaining the continuity of essential service provision, while work proceeds. The staging of works and operations needs to be programmed so that essential service provision is uninterrupted.
- integrating new service providers into an operational environment
  - management of existing staff
  - non-core PPP contractor must not disrupt core service provision
  - ensuring some flexibility within the payment mechanism to permit the PFP to accommodate day-to-day or other unforeseeable changes to government activities
  - permitting the contractor to take over services prior to construction completion.

## **Conclusion**

- Privately Financed Projects will continue to be an important procurement option for the Government going forward. It will be used where the project is needed for government objectives and it produces value for money.
- Consistent with the outcome of recent inquiries, PFP processes will be refined.
- Upcoming PFPs are likely to feature the bundling of more private sector service provision, where this is appropriate - and more projects on brownfield sites.
- More opportunities for the private sector will arise but also more challenges. Government requirements need to be really understood and services provided in a co-operative manner with Government and also on occasion with NGOs and other non-private sector service providers.