

# Partnerships Victoria



## Will PPPs Survive?

- John Fitzgerald, Deputy Secretary
- CEDA Forum – The Future of PPP's

Melbourne

12 March 2009



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## Agenda

- **Are PPPs Dead?**
- **Some Context**
- **The role of PPPs**
- **Will PPPs Survive?**



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## 9 December 2008

- ‘Darren Olney-Fraser, the chief executive of Australian Public Trustees, a boutique investment company specialising in government leased assets, said public private partnerships were “dead in the water” for at least the next 12 months...’
  - *Super Chiefs Dump Public-Private Deals*, Australian Financial Review



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**15 December 2008**

- Victoria's Premier announced that the *Axiom Education Victoria Consortium* would design, build, finance and maintain 11 new schools located in Melbourne's West, South and North for a 25-year period as a public private partnership.



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## Some Historical Context

- What is a normal market? 2007 or 2002?
- In the 1990s, some questioned the market's ability to finance the CityLink project



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## Cause and Effect

- The GFC has affected financing pricing, tenor, capacity and volatility
- Some commentators have interlinked GFC issues with other, more medium term issues, such as:
  - demand or traffic risk on toll roads
  - concerns around complex procurement processes





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## Infrastructure spending

- There has been a significant shift in thinking, with the Federal and State Governments announcing significant increases in infrastructure spending, responding to:
  - issues of population growth such as:
    - traffic congestion
    - power supply
    - water supply
  - supply chain bottlenecks hampering national productivity
  - concerns about an economic slowdown.
- The Commonwealth has dealt itself back into the infrastructure space with the establishment of Infrastructure Australia and the BAF.



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## The role of PPPs

- Until quite recently, PPPs were a nascent industry – a relatively little-used procurement method embraced by some States (Victoria and NSW) but not others
- Most States and the Commonwealth are now very keen to explore PPPs for the:
  - value for money they generate
  - risk transfer they facilitate
  - innovation that can arise
  - flexibility PPPs afford to government cash flows.



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## PPPs and economic stimulus

- PPPs can take longer than traditional projects to reach contract execution
- However the commercial drivers in PPPs can facilitate shorter construction times, bringing forward expenditure
- The demonstrated cost and time certainty advantages of PPPs are particularly valuable in the current environment



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## PPP cost and time efficiency in Australia

- Benchmarking study conducted by Melbourne University for the National PPP Forum
  - Released in December 2008
  - Available at [www.infrastructureaustralia.gov.au](http://www.infrastructureaustralia.gov.au)
  - Reviewed 25 PPPs and 42 traditional projects
  - Robust methodology, avoiding criticisms of earlier overseas studies such as the Mott McDonald UK study
- Accounting treatment is inconsequential



# Australian National PPP Forum

## Benchmarking Study (source: Duffield 2008)

Cost over-runs: Traditional and PPP projects relative to anticipated cost at the start of the period under consideration (based on averages)

	<b>Full Period</b>	<b>Stage 1</b>	<b>Stage 2</b>	<b>Stage 3</b>
No. of Observations	40	45	43	40
A. Traditional Projects	52.0%	38.2%	19.7%	18.0%
B. PPP Projects	23.8%	22.2%	7.8%	4.3%
Difference (A - B)	28.2%	16.0%	11.9%	13.7%



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## Allen Consulting Group / The University of Melbourne (2007)

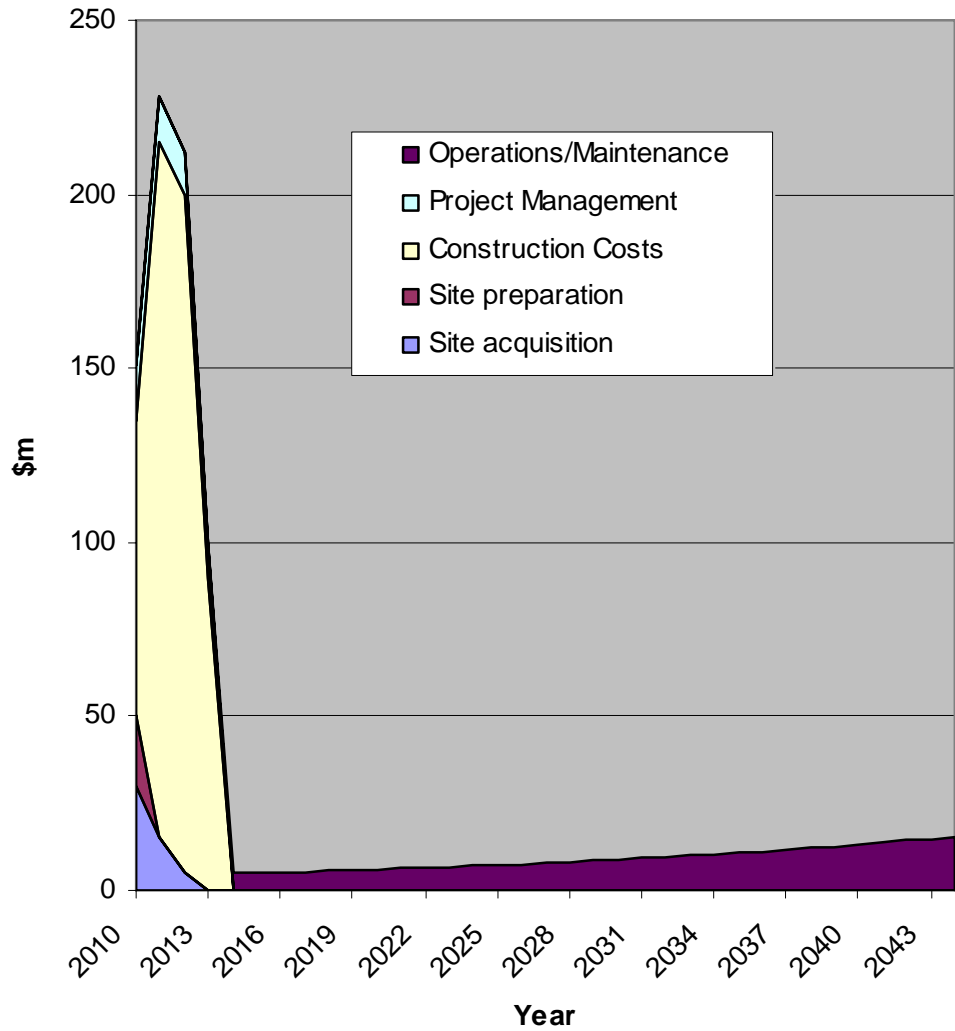
TOTAL COST OF TRADITIONAL & PPP PROJECTS (\$M)

		Expected Cost	Net Cost Over-run	Final Cost	% Cost Over-run
Full Period:	Traditional	3,082.0	1,087.6	4,169.6	35.3%
Original Approval – Final	PPP	4,484.4	519.3	5,003.7	11.6%
Stage 3:	Traditional	4,532/6	672.5	5,205.1	14.8%
Contract – Final	PPP	4,946.1	57.6	5,003.7	1.2%

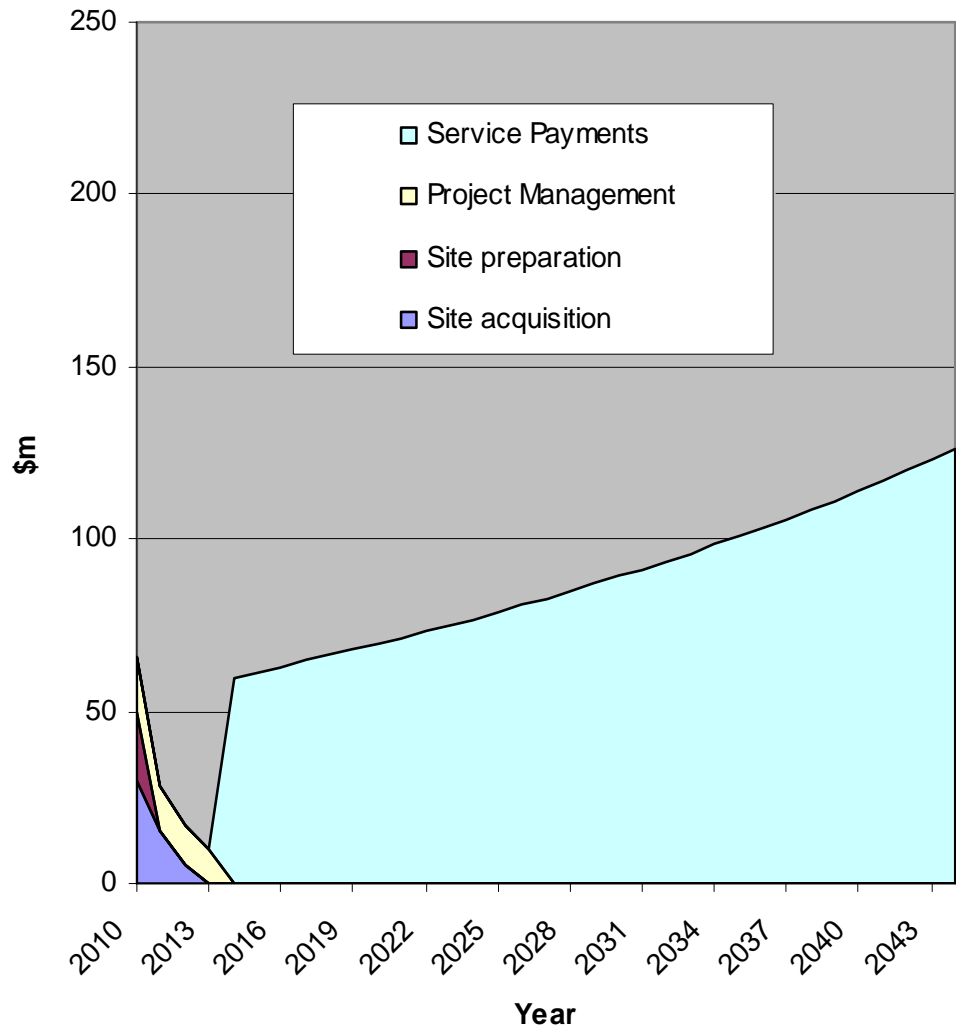


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### Traditional Delivery Cash Flows



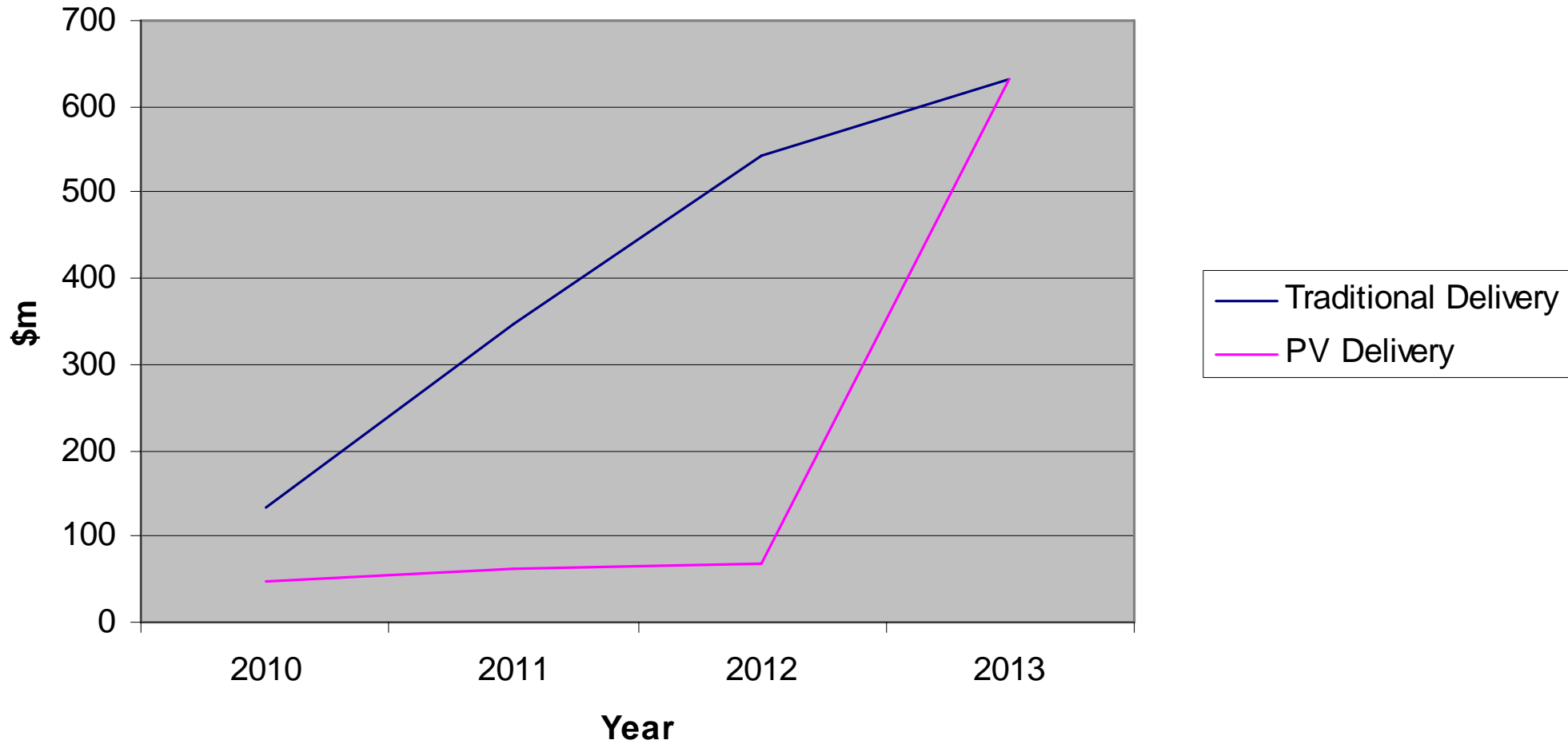
### PPP Delivery Cash Flows







## Balance Sheet Impact





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## Measuring Value for Money

- Difference between cost of PPP and the PSC (the hypothetical risk adjusted cost of Traditional delivery)
- Is the focus only on PSC an underestimate?
- Research Results Strongly Support This Hypothesis



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## Performance of PPPs compared to traditional procurement

Research	Findings
Treasury Taskforce (2000)	Cost savings of 17% for PPPs based on 21 projects
Haskins et al (2002)	Cost savings on the PPP project's Capex component varied between 30% and 40%
Mott MacDonald (2002)	Capital expenditure resulted in: <ul style="list-style-type: none"> <li>• 1% cost overrun on average for PFI/PPP projects, and</li> <li>• 46% cost overrun for Traditional procurement projects.</li> </ul>
Fitzgerald (2004)	VFM in the order of 9% was achieved against the project's corresponding PSC.
Allen Consulting Group (2007)	Cost overruns: <ul style="list-style-type: none"> <li>• 35.3% experienced by Traditional projects, and</li> <li>• 11.6% in the case of PPPs.</li> </ul>
Duffield (2008)	Average cost overruns experienced: <ul style="list-style-type: none"> <li>• 52% by Traditional projects and</li> <li>• 23.8% by PPPs</li> </ul> <p style="text-align: center;">A difference of 28.2%.</p>



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## **Additional VFM:**

### **A. Increased Scope**

- **East Link Freeway:**
  - Longer Tunnels
  - An additional Bypass
  - Additional Lanes, Enhanced noise walls, lighting, etc.
- **Royal Children's Hospital:**
  - Expanded food & retail operations
  - Larger gross building area c/w Reference Project
  - World class 'iconic' design.



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## **Additional VFM:**

### **B. Public Interest Test**

- effectiveness;
- accountability and transparency;
- affected individuals and communities;
- equity;
- consumer rights;
- public access;
- security; and
- privacy.



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## **PPPs in an illiquid financial environment**

- Good PPPs are still viable in the current market
- Funding constraints may cap project size
- Policy responses may be required to ensure finance can be secured, particularly for larger projects
- In a degereared world, higher levels of equity helps protect debt from risk
- Policy responses may also impact on traditionally delivered projects



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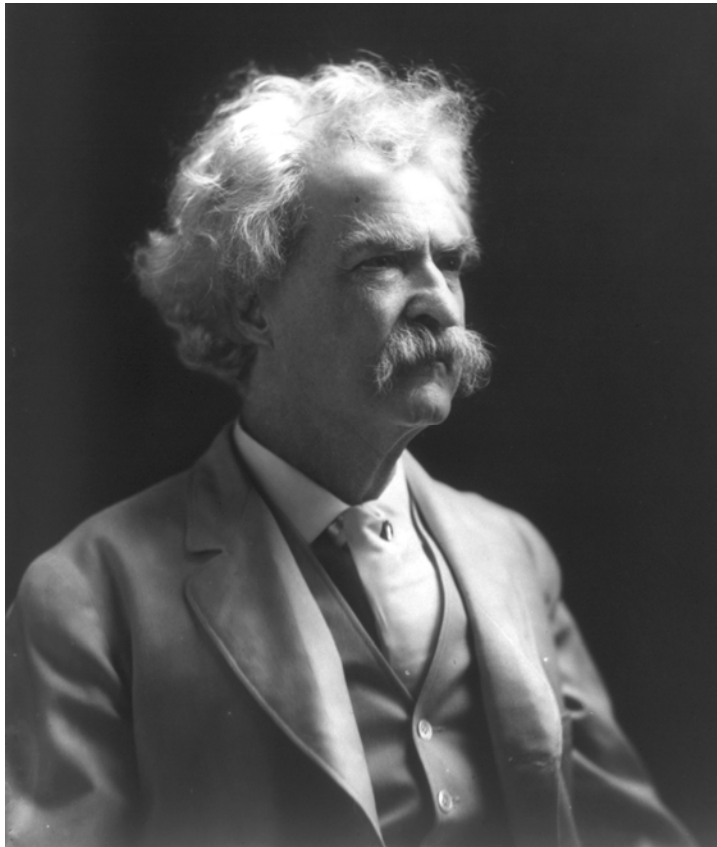
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## Will PPPs Survive?



- “Reports of my death are greatly exaggerated”
  - Mark Twain





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## Why will PPPs survive?

- The PPP model is not broken (even if financial markets are suffering)
- For appropriately selected projects, PPPs offer value for money, risk transfer, innovation, cash flow flexibility, cost and time certainty and improved scope – all important in the current environment.



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**Conclusion: Can PPPs Continue to Deliver?**



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Research	Findings	Assessment
Fitzgerald (2004)	<b>VFM</b> in the order of <b>9%</b> was achieved against the project's corresponding PSC.	✓
Mott MacDonald (2002)	Capital expenditure resulted in: <ul style="list-style-type: none"> <li>• <b>1% cost overrun</b> on average for <b>PFI/PPP</b> projects, and</li> <li>• <b>46% cost overrun</b> for <b>Traditional</b> procurement projects.</li> </ul>	✓✓
National Audit Office (2003)	<b>78% of PFI Projects</b> were delivered <b>on budget</b> , compared to <b>27% on budget for Traditional</b> (government) procurement.	✓✓
Allen Consulting Group (2007)	Cost overruns: <ul style="list-style-type: none"> <li>• <b>35.3%</b> experienced by <b>Traditional</b> projects, and</li> <li>• <b>11.6%</b> in the case of <b>PPPs</b>.</li> </ul>	✓✓
Duffield (2008)	Average cost overruns experienced: <ul style="list-style-type: none"> <li>• <b>52%</b> by <b>Traditional projects</b> and</li> <li>• <b>23.8%</b> by <b>PPPs</b></li> </ul> <p style="text-align: center;">A difference of 28.2%.</p>	✓✓
Standard & Poors (2007)	Of 161 survey responses, <b>61% believe PPPs have a better track record of delivery</b> than Traditional procurement, 30% said ' <i>it depends</i> ' and 9% disagreed.	✓✓
Ernst & Young (2008)	In a recent report, Ernst and Young concluded that overall the <b>(PPP) projects delivered on their value promise</b> .	✓✓
Public Interest Test	Recent <b>PPP projects</b> have resulted in <b>additional outputs</b> , whilst <b>satisfying robust public interest tests</b> .	✓✓

Legend: ✓ Possible      ✓✓ Highly Possible



## A Final Thought

- A premature obituary published for arms manufacturer Alfred Nobel, condemning him as a “merchant of death”, may have motivated him to create the Nobel Prize.
- Can we respond to the premature PPP obituaries and challenging market conditions by improving the model?