



Government Response to the Public Accounts and Estimates Committee *Report on private investment in public infrastructure,* *October 2006*

In 2002 the Public Accounts and Estimates Committee (PAEC) commenced an inquiry into private investment in public infrastructure. The scope of the inquiry included:

- an overview of major infrastructure projects in Victoria involving private sector funding since 1990, with particular emphasis on issues relating to risk allocation and protection of the public interest, and the outcomes of these projects in terms of public benefits and costs;
- a review of Victorian, Australian and international legislative and policy frameworks and practices regarding private sector investment in public infrastructure including governance and accountability arrangements; and
- a review of the mechanisms used by the Victorian Government to evaluate whether these projects represent value for money for the government and the community.

The inquiry extended through the 54th and 55th Parliaments, reporting immediately prior to the proroguing of Parliament for the November 2006 election. The report was tabled in Parliament on 4 October 2006.

The *Partnerships Victoria* policy was introduced in June 2000 and provides the framework for a whole-of-government approach to the provision of infrastructure and related services through Public Private Partnerships (PPPs).

Since 2000, 16 *Partnerships Victoria* projects have been contracted worth around \$4.5 billion of capital investment. An additional three projects are in the market or being prepared for delivery as a *Partnerships Victoria* project.

The *Partnerships Victoria* policy is designed to tap into private sector expertise in designing, building and maintaining large infrastructure projects.

Value for money is the driver for the adoption of a *Partnerships Victoria* approach, rather than capital scarcity or balance sheet treatment. In fact the vast majority of *Partnerships Victoria* projects are on the State's balance sheet.

Importantly, under *Partnerships Victoria*, any assessment of a potential project must include an assessment of whether the public interest can be protected, and Government retains sole responsibility for delivery of 'core services'.

The *Partnerships Victoria* policy is only applied where extensive analysis shows that this delivery method will deliver better value for Victorians than any other delivery method.

There have been strong indications to date of the benefits of the *Partnerships Victoria* approach. An independent review of *Partnerships Victoria* in 2002 found that for each of the eight projects reviewed they were equal to or better value than public sector provision. Overall, the weighted average saving was 9 per cent against the public sector comparator (PSC), using the then prevailing discount rate.

The EastLink project provides an example of the benefits and innovative outcomes these projects can achieve. The project achieved capacity and features not originally anticipated, including 10 kilometres of additional traffic lanes (each way). In addition, an \$85 million Dandenong Southern Bypass and Ringwood Bypass will be provided toll free. The project also includes additional local road improvements and ConnectEast, the private provider, has paid \$20 million for local rail station upgrades. Improved urban design and amenity enhancements were also achieved, with higher standard noise walls and additional landscaping and wetlands.

Partnerships Victoria is about packaging projects in a way that ensures lower overall cost to the State and improved services to the community. Competition between bidders for a whole-of-life asset and related services provides scope for innovation and other factors to achieve efficiency savings above those achieved under equivalent public sector delivery and financing.

It is a myth that the value for money outcomes achieved in *Partnerships Victoria* projects are compromised by higher private sector borrowing costs.

The Government's ability to borrow more cheaply is purely a function of its capacity to levy taxes to repay borrowings. Credit markets perceive this power as reducing the risk of their investment and therefore will lend to government at lower rates. However, when it comes to raising finance for a project, it is the risk of the individual project that determines the real cost of finance. The difference between the private and the public sectors is that private sector capital markets explicitly price in the risks of a project into its sources of finance. This is not the case in the public sector.

Instead, taxpayers implicitly subsidise the cost of the project by bearing the risk of cost overruns, time delays or performance failures, which are not priced into the Government borrowing rate.

The importance of the finance element of privately provided infrastructure lies in the incentive it can provide for the performance of that infrastructure, and the disciplines external financiers can provide on the delivery of projects to time and budget. While a key objective of Government is to achieve a more comprehensive upfront consideration of risks in conventionally financed projects, it is difficult to replicate the strength of private financing incentives within a conventional financing process where all risks of delivery reside with Government.

Value for money in *Partnerships Victoria* projects is underpinned by optimal risk allocation between the private and public sectors. One criticism often levied at *Partnerships Victoria* is that the transfer of risk is not real. The recent experience of Southern Cross Station, in which the private sector met the majority of unexpected additional construction costs, is evidence that PPPs do transfer risk to the private sector.

The infrastructure landscape has evolved with new projects introduced under *Partnerships Victoria* and early ones reaching stages of completion. There have been lessons learnt from these processes that have shaped the development of *Partnerships Victoria* policy and guidance over time.

The PAEC report has identified many issues that pre-date *Partnerships Victoria* policy, have already been addressed in guideline development, or are currently under consideration. Examples of key developments include:

- **Improved accountability and transparency in contracting.** The Treasurer recently released a *Partnerships Victoria* Disclosure Policy requiring that a project summary be released detailing, among other things, how the project delivered value for money and met the public interest. This project summary will also be tabled in Parliament by the responsible project minister;
- **Release of Standard Commercial Principles in 2005.** The main concern raised by industry in consultation processes is the need to reduce the cost of bidding and improve the efficiency of the bid process and in particular, increase risk standardisation. To this end, the Standard Commercial Principles document was released in June 2005. These principles, currently being updated, represent the considered position of the State in relation to *Partnerships Victoria's* risk allocation at that time; and
- **Ongoing Policy Review and Development.** Victoria is at the forefront of policy development, being the first jurisdiction to introduce a formal Interactive Tendering Process for PPPs. Victoria has also led the way in the development of guidance for the ongoing management of PPP contracts.

It is pivotal that the model continue to evolve in a complex environment. Victoria will continue to address lessons from projects here, elsewhere in Australia and overseas to ensure that it drives innovation and value for money outcomes in PPP infrastructure delivery.

Response to PAEC Recommendations

PAEC has proposed 20 recommendations, 11 of which are fully or partially implemented. Of the remaining recommendations four are not agreed in full.

Recommendation 1

All major infrastructure projects including PPPs be subject to independent post project reviews at the completion of the construction phase and during the operational phase to measure the degree to which agreed outcomes are met. All results be periodically reported to Parliament.

Agreed in part

Since 1999, the Government has invested \$13 billion in projects for Victorians. Over the next four years we will spend an average of \$3.2 billion a year on infrastructure. In meeting Victoria's infrastructure requirements it is vital that the public is confident that projects are based on responsible guidelines and deliver value for money. The Government has implemented a number of reforms to increase accountability and transparency for infrastructure projects, including:

- Requiring government contracts to be published and easily accessible by the community;
- Implementing the Gateway Review Process to improve selection and management of major projects; and
- Restoring the independence of the Auditor General.

The Government's Gateway Review Process for assets involves independent reviews to confirm readiness for service, and to assess in-service benefits post construction. These reviews apply to high risk asset investment projects and *Partnerships Victoria (PV)* projects. The results of these reviews are not made publicly available due to the confidentiality arrangements of the Gateway Review Process. This confidentiality is integral to instil confidence in departments and agencies that the process is independent of external influences and to promote open and frank advice from reviewers. The results of these reviews inform the ongoing successful management of these projects and the development of best practice guidelines.

The Auditor General's Office undertakes a number of performance audits each year within the public sector on infrastructure projects. These reviews encompass assessments of the economy, efficiency and effectiveness of the management of public resources by the government or individual agencies of government. The scope of audits is at the discretion of the Auditor General.

Building on current initiatives to promote openness and transparency in infrastructure projects, the Government has also committed to produce an annual review of key state infrastructure projects, including a description of the nature, strategic importance and progress of the project. Implementation of this initiative is currently under development.

Recommendation 2

Before proceeding with any further build, own and operate projects, the Government ensure that public benefits are maximised.

Agreed and in place

Under *PV* policy, public benefit is maximised through ensuring that value for money is achieved and the public interest is protected. All *PV* projects are required to undertake a public interest test to determine whether suitable measures can be established that adequately protect the public interest and whether an inability to do so renders a *PV* approach inappropriate.

In its discussion of build, own and operate projects, the Report (pages 60-61) refers to the Mildura Hospital and County Court projects. It should be noted that these are not recent projects and do not necessarily reflect the ongoing refinement of PPPs under the *PV* policy. The Mildura Hospital contract was entered into prior to the introduction of the *PV* policy. The County Court contract was tendered at a time when the *PV* policy was under development, and prior to development of the detailed *PV* guidance material. The Government ensured that the County Court project represented value for money prior to agreeing to enter into the contract.

Since the County Court project was contracted, no subsequent *PV* project has used a similar build, own, operate model. In the majority of subsequent projects, the facility is automatically transferred back to government at the end of the concession term.

While there may be isolated future instances where the build, own, operate model offers superior value for money and satisfies the public interest, widespread use of this model is not envisaged.

Recommendation 3

Long term peppercorn leases extending beyond the concession period should not be given to a private consortium, unless it can be clearly demonstrated that there is a public benefit.

Agreed and in place

The State's processes for determining how and to what extent commercial development opportunities should be made available to bidders, and for evaluating commercial development proposals, include consideration of whether peppercorn rentals offer a public benefit when viewed in the context of the project as a whole.

For leases in relation to complementary commercial developments, the public benefit of peppercorn leases must be considered in the context of all of the terms of the lease, including any requirement for payment of an up-front premium. For example, in the commercial development at Southern Cross Station, bidders were able to bid for commercial development rights under peppercorn leases, but had to nominate an up front premium they would pay in return for receiving a lease on these terms. The up front premium (which can be regarded as rental in advance) assisted the State to finance the core Station project—in other words, the private consortium, through the up front premium for commercial development, reduced the overall cost to taxpayers of the project. If the State had required a market rental for the commercial development leases, bidders would make corresponding reductions in the up front premiums that they offered.

In relation to the core project, where leases of the core project site extend beyond the concession period, this refers to the same issue as Recommendation 2. While there may be isolated future instances where peppercorn leases of the core project site extending beyond the concession term offer superior value for money and satisfy public interest requirements, widespread future use of such leases is not envisaged.

Recommendation 4

All existing public private partnership projects involving operating leases be reviewed to determine whether they should be reclassified to finance leases under current accounting standards.

Agreed and in place

The balance-sheet treatment of a project is not the driving force behind the use of a PPP delivery approach in Victoria. The majority of *PV* projects have been classified as finance leases in accordance with accounting standards and as such are recognised on the Government's audited balance sheet.

Government's policy is that *PV* projects will comply with accounting standards of the day and projects are regularly reviewed to ensure this compliance. However, there is not a dedicated public sector accounting standard to apply to PPPs, hence legitimate opinions may differ.

The Auditor General's Office recently undertook a selective review of PPPs in 2006 involving operating leases to see if they should be reclassified to finance leases under the current accounting standards. A number of Victorian PPPs were reclassified (consistent with the Auditor General's initiative and resulting assessment). It is at the discretion of the Auditor General to determine if further reviews be undertaken.

Effective for the 2008-09 annual reporting period, a new AASB standard on PPPs is to apply to private sector operators only. The status of accounting by public sector grantors is being reviewed by the AASB. A further review of projects will be considered to ensure compliance of reporting of PPP projects with any applicable new standards.

Recommendation 5

Public private partnership contracts should include the total amount of payments outlining the total government commitment and the impact on state debt. This information should be published on the *Partnerships Victoria* website, with summary information included in the state budget papers.

Agreed in part

The Treasurer announced a new *PV* disclosure policy in March this year. A key requirement of this policy is the introduction of project summaries for *PV* projects. These summaries will detail, amongst other things, project cost and how the project delivered value for money and the met the public interest. It will also detail a summary of key elements of the project, including the net present value of the service payments at that time.

The extent of disclosure in the project summaries does not extend to payment schedules. This information can be misleading to the public as it may vary throughout the contract term dependent on contractor performance and other factors. For example, when a house is purchased, the price is considered in today's dollars. This represents the Net Present Value, not the sum of loan payments, interest and other associated maintenance costs over the life of the asset.

Additional information on project costs, such as the commitment for the project in nominal terms, is already disclosed in departmental annual reports, the annual financial report and the budget papers. The impact on state debt is also considered and disclosed in budget papers.

State debt is outlined in the budget papers as part of a broader discussion on the impact of the Government's infrastructure investment program on debt. As detailed in the budget papers for 2006-07, around 60 per cent of the Government's infrastructure investment program is currently funded by cash operating surpluses. The balance is funded from surplus financial assets and through debt. While debt impact is addressed at the aggregate level, it is not always possible to definitively determine the impact of an individual project on debt.

Recommendation 6

Further guidance material be developed to cover the situation where, during the course of the public private partnership contract, transferred risk reverts to the Victorian Government.

Not Agreed

The *PV* guidance material recognises that the risk transfer that occurs in *PV* projects is a transfer of the financial consequences of risks occurring, not a transfer of the State's ultimate responsibility for delivery of public services. The *PV* Risk Allocation and Contractual Principles guide (June 2001) and Contract Management Guide (June 2003) both explain this distinction.

It would be inappropriate for the State to develop guidance material on the transfer back to government of risk that had previously been allocated to the private sector. However, the Government has examined lessons from past projects such as the Latrobe Regional Hospital (signed in 1997), and has developed guidance on how to allocate risks appropriately at the outset and then maintain the agreed risk allocation over the life of the contract. The success of PPPs contracted under the *PV* policy demonstrates the appropriateness of the risk allocation between the Government and the private sector.

In addition, the *PV* Standard Commercial Principles provide guidance on initial risk allocation. The *PV* Contract Management Framework provides guidance on managing contracts to ensure contractors continue to bear the financial consequences of the risks allocated to them.

The Southern Cross Station project illustrates the contractual risk allocation in a *PV* project. In that project, a number of different risks materialised and resulted in higher than expected construction costs. Some of the risks that materialised were contractually allocated to the State, either wholly or on a shared basis, but the majority of the cost overruns were a result of risks allocated to the private consortium. Consequently, the private consortium met the majority of the unexpected additional construction costs.

Recommendation 7

The Victorian Government develop a policy on maximising the benefits to the state from commercial opportunities arising from public private partnership arrangements.

Agreed and partly in place

The benefits to the State of commercial opportunities arising from PPPs are primarily assessed with regard to value for money and public interest principles. These key principles are documented in the *PV Practitioners' Guide* of June 2001.

It is noted that commercial opportunities embedded within a PPP proposal act to either generate a value for money benefit to the State or to enhance the overall amenity of that infrastructure. Competition in bidding provides an incentive for bidders to maximise the value to Government in their bids, including the commercial development component. The value to the State from the inclusion of such opportunities is assessed on a project by project basis with respect to the criteria outlined above and also through an assessment of the level of synergy between the PPP and commercial elements of the proposal. As part of this assessment, an independent valuation of the site is provided by the Valuer General.

While the value for money and public interest tests represent well established and defined criteria, Government notes that existing processes for assessing the value of commercial opportunities in PPP proposals might be usefully supplemented to reflect current practices and thinking. Government will monitor this issue going forward and consider providing additional guidance in this area through an update to its *PV Practitioners' Guide*.

Recommendation 8

Timeframes should be reduced, where possible, for the period of concession agreements so as to limit the impact of debt repayments for future governments.

Not Agreed

PV projects meet long-term service needs through the provision of long-life infrastructure assets.

Fundamentally, the duration of concession terms are based on value for money and public interest considerations, together with the service requirement. A key driver of value for money is whole-of-life costing, which results from the full integration, under the responsibility of one party, of up-front design and construction costs with ongoing service delivery, operational, maintenance and refurbishment costs. The concession term needs to be long enough to effectively transfer whole of life risk. This generally requires a term of 25 years or more. Shorter concession terms will not effectively transfer whole of life risk, and hence will reduce the opportunities for value for money outcomes to be delivered, without reducing the underlying infrastructure asset cost.

Recommendation 9

The Victorian Government continue to work with the Commonwealth Government on the need to reform section 51AD of the *Income Tax Assessment Act 1936* to protect the taxpayers' interest in a way which facilitates projects while protecting the public interest.

Agreed and in place

The State is working with the Commonwealth in relation to PPP taxation matters.

The final John Ralph report on the (Commonwealth) Review of Business Taxation – A Tax System Re-Designed: July 1999, page 392 recommended (inter alia)... “That S 51 AD be abolished...”

Victoria, and the other States, agree that S 51 AD should be repealed. However, income tax law lies in the Commonwealth jurisdiction. Since March 1999 Victoria has been directly involved in a federal stakeholders' forum examining S 51 AD and related matters. Victoria has consistently argued for a more consistent, non-punitive, revenue neutral approach to the income taxation treatment of infrastructure projects and will continue to negotiate with the Commonwealth to work towards a mutually satisfactory outcome.

Recommendation 10

The *Partnerships Victoria* policy and guidelines be updated to reflect recent experiences with public private partnership/private finance initiative projects in Australia, particularly in relation to the public sector comparator, valuing risk, and the discount rate.

Agreed and in place

PV policy continues to be updated to reflect experience and market developments (e.g. Standard Commercial Principles released June 2005).

In a more practical sense, experiences from past projects are continually being embedded into new projects. A recent illustration of this involves the Royal Children's Hospital (RCH) project. The draft RCH Project Agreement incorporates numerous refinements to the agreements used on previous PPP projects, partly in response to experience gained from the Royal Women's Hospital and other projects, and partly as a result of greater sophistication in the approach to dealing with a number of design, construction and operational issues.

The parts of the draft RCH Project Agreement that have been heavily reworked include sections on the following:

- the design development process generally, including the obligations of the Project Company;
- modifications / change compensation principles – the regime addressing the pricing of modifications has been completely reworked to ensure greater transparency particularly in relation to preliminaries and margins, and to minimise the scope for disputes; and
- payment mechanism – development of a new and simplified payment mechanism.

Further guidance with regard to various financing issues is currently under consideration. *PV* policy updates will consider the areas specifically identified as part of recommendation 10 (i.e. the PSC, risk and discount rate).

Recommendation 11

The Victorian Government:

- (a) improve opportunities for parliamentary oversight of public private partnership financial arrangements and commitments;
- (b) after the contractual arrangements relating to a public private partnership project have been finalised, the responsible Minister and the Department of Treasury and Finance brief the Public Accounts and Estimates Committee on the details; and
- (c) advise Parliament when significant variations are made to a PPP contract, beyond the initial contractual arrangements.

Agreed in part

The Treasurer announced a new *PV* disclosure policy in March this year. A key requirement of this policy is the introduction of project summaries for *PV* projects. These summaries will detail, amongst other things, project cost and how the project delivered value for money and the met the public interest. It will also detail a summary of key elements of the project. Consistent with the policy, these project summaries will be tabled in Parliament by the responsible project minister within three months of financial close and will also be available publicly on the *Partnerships Victoria* website. Departments and agencies are also required to update the project summaries where there are significant changes to the nature of the project post publication. This initiative will increase information available to Parliament and the public on the specifics of *PV* projects.

PAEC has the opportunity to discuss the specifics of the project with the responsible minister as part of the budget estimates inquiry process. Officers from the responsible department or agency can also address specific project information as part of the PAEC broader inquiry process.

In addition, departments are required to publish contracts over \$10 million in full on the Government's contract website. Any exemptions to this disclosure must be justified under the provisions of the *Freedom of Information Act 1982* (Vic). Consistent with whole of government policy, departments must also publish contract variations in excess of \$100,000 on the Government's contracts site.

Recommendation 12

That:

- (a) prior to tenders being submitted for public private partnership projects, agencies should ensure applicants are aware of the limits of what will and will not be considered as commercial in confidence in relation to PPP contracts; and
- (b) in determining whether a claim for commercial confidentiality is justified, the onus of proof should be with the tenderer, who should be required to substantiate that disclosure would be harmful to their commercial interests.

Agreed and in place

PV tender documentation and the *PV* Standard Commercial Principles provide clear guidance to tenderers on the extent of their confidentiality obligations during the tender process and once the *PV* contract has been signed. Importantly, *PV* documentation clarifies that confidentiality of all matters relating to the project is subject to Government's legislative disclosure obligations (including, under the *Freedom of Information Act 1982* (Vic) (FOI), the *Ombudsman Act 1973* (Vic) and the *Audit Act 1994* (Vic)) and satisfaction of all Parliamentary and other public sector accountability and governance requirements.

Under *PV* arrangements, Government is entitled to disclose (on the internet or otherwise) the *PV* contract and any associated documents or information except to the extent such information is commercially sensitive or otherwise confidential. This reflects the current FOI Act exemptions. The onus is on the tenderer to identify any commercially sensitive information that should be treated as confidential and should therefore remain undisclosed. This is reflected in the *PV* Standard Commercial Principles.

Recommendation 13

That:

- (a) after public private partnership contracts are signed, the contracts be published on the *Partnerships Victoria* website within three months;
- (b) a succinct (approximately three page) summary of the contract and a value for money report be prepared, modelled on the British Columbia value for money report, and include the following information:
 - the assets that are to be transferred from the Victorian Government to the private sector;
 - the price to be paid by the Government and the basis for future changes in the price;
 - the provisions for renegotiation;
 - the risk sharing in the construction and operational phases;
 - significant guarantees or undertakings;
 - details of the public sector comparator.
- (c) the Victorian Auditor General review the details included in the contract summary and certify that it is an adequate reflection of the terms and conditions of the contract and arrange for the publication of the statement on the *Partnerships Victoria* website.
- (d) the Department of Treasury and Finance develop a template outlining information to be included in the summary of the public private partnership contract and the value for money report, and advise departments.

Agreed in part

The Treasurer announced a new *PV* disclosure policy in March this year. A key requirement of this policy is the introduction of Project Summaries for *PV* projects within three months of financial close. These summaries will detail, among other things, how the project delivered value for money and met the public interest. They will also detail a summary of key elements of the contract. A template will be provided to detail these requirements. Consistent with the policy, these project summaries will be tabled in Parliament by the responsible project minister and will also be available publicly on the *Partnerships Victoria* website.

The Auditor General will have the opportunity to review this documentation as part of normal review processes. The scope of audits is at the discretion of the Auditor General.

The Government will also consider the recommended timeframe for release of *Partnerships Victoria* contracts undertaken by Departments.

Recommendation 14

The Victorian Government make representations to the National PPP Council to jointly fund a study on the potential financing options available to governments to fund public infrastructure projects, including the economic and social impacts of each option and publicly release the report for comment. In the event that the National PPP Council does not agree to this proposal, the Victorian Government fund such a study.

Not agreed

The options available to fund infrastructure are already clearly established.

As stated in the Budget Papers 2006-07, around 60 per cent of the Government's infrastructure investment program is currently funded by cash operating surpluses. The balance is funded from surplus financial assets and through debt.

During the preparation of the business case, each department will consider alternative funding options. *PV* policy dictates that all projects approved in-principle for delivery under *PV*, and which Government is committed to construct irrespective of the outcome of the *PV* procurement process, must initially be budgeted for as though delivery will be via traditional procurement within the available budget funding threshold.

Funding for individual projects will be impacted by the procurement model selected and the agencies involved in the project, with alternate funding sources outside of the budget envelope considered.

Recommendation 15

The Victorian Government:

- (a) develop a secondment model within the public sector so that public officials with experience in complex procurement processes can be retained and deployed on projects across the public sector;
- (b) take steps to ensure Major Projects Victoria and individual departments are appropriately resourced to manage public private partnership projects;
- (c) develop individual and team procurement skills through formal qualification training; and
- (d) ensure the performance criteria and targets for senior public officials involved in public private partnership projects and traditional procurement are linked to completing projects on time and within budgets.

Agreed in part and in place

Although there is no formal secondment model across the public sector, Government does consider whether agencies/departments managing PPPs are appropriately resourced and formal training for some procurement processes, including *PV* contract management, exists.

Skilled project directors are a limited resource within government and the private sector. The employment of external specialist resources helps to supplement and complement the skills of the existing pool of public sector infrastructure project management staff.

It is further noted that issues regarding appropriate resourcing of infrastructure projects and the development of procurement skills through formal training are also being addressed in a review of infrastructure project management capability by the State Services Authority. Government considers it would be appropriate to wait until this review is finalised to assess any further action to be undertaken.

In regard to performance criteria for senior public officials involved in PPPs, it is noted that such criteria are already constructed with respect to a range of factors, including but not limited to, the delivery of infrastructure on time and within budget.

Recommendation 16

The Victorian Auditor General periodically undertake performance audits of all major public private partnership projects to determine whether value for money is being maintained over the life of a project.

Agreed and in place

The Auditor General's Office undertakes a number of performance audits each year within the public sector. These reviews encompass assessments of the economy, efficiency and effectiveness of the management of public resources by the government or individual agencies of government. The scope of audits is at the discretion of the Auditor General.

Under the *Audit Act 1994*, several statutory responsibilities are assigned to PAEC in relation to the work of the Auditor General, providing an opportunity for input. These responsibilities include:

- review of the Auditor General's draft annual work plan; and
- a consultative role in the formulation of objectives and scope for all performance audits undertaken by the Auditor General.

Recommendation 17

The value for money tools used for *Partnerships Victoria* assessment be revised to include:

- (a) benchmarked comparisons where these are possible;
- (b) a full range of alternative funding options (including public sector funding through the budget);
- (c) an indication of the accuracy of the public sector comparator;
- (d) a precise definition of the traditional public sector alternative option under consideration; and
- (e) a publicly available explanation of how the public sector comparator is used to compare tender bids.

Agreed and in place

Comparative data is used to inform the development of project requirements, evaluation and costing for *PV* projects. In this respect projects are benchmarked against best practice.

Benchmarked comparisons were used in the Eastlink project, where the PSC became one of several factors used by the State in evaluating the competitive proposals it received from the private sector. Other factors included:

- the comparative cost of the roadway to users (initially and over time);
- innovations which offered improved value for money;
- the proposed approach to delivery of the project;
- the financial and risk consequences for the State of the bidder's proposal;
- the length of the proposed concession period; and
- proposals for State participation in revenue or profit sharing with the Concessionaire.

During the preparation of the business case, and in particular the procurement options analysis, each agency considers alternative funding options. These include design, build, finance and operate (DBFO) projects as well as design, build and operate (DBO) projects. *PV* projects delivered under the DBO model, such as the Wodonga Wastewater project, are publicly financed rather than privately financed. The public sector alternative against which *PV* bids are compared is identified as part of the analysis of procurement options and will vary from project to project, as it reflects the most appropriate non *PV* delivery method.

The *PV* guidance material (available at www.partnerships.vic.gov.au) clearly explains how the public PSC is constructed and used in the procurement process.

PSCs used in *PV* projects generally use Monte Carlo analysis to determine the cost of risks occurring and their likelihood. This analysis

produces a PSC probability distribution that indicates the range of likely cost outcomes for traditional delivery of the project. This methodology is explained in the *PV* Technical Notes and is consistent with risk management techniques used worldwide on many types of projects.

Recommendation 18

An independent assessment be made of the relative cost performance, efficiency and timeliness of all privately funded projects, similar to the Mott MacDonald (United Kingdom) report.

Agreed and under consideration

Negotiations are underway for a further study to be undertaken through the National PPP Forum. This proposal will be formally considered by the Forum at its next meeting.

Recommendation 19

The Victorian Government make representations to the National PPP Council to arrange for an independent study into the size, structure and competitiveness of the Australian public private partnership market to determine the degree to which its diversity is sufficient to be fully competitive.

Agreed in part and in place

The Victorian Department of Treasury and Finance, together with relevant New South Wales and Western Australian government departments, has agreed to collaborate with Queensland University of Technology and the Construction Industry Institute of Australia on a significant research project entitled "*Major Infrastructure Projects in Australia's Public Sector: Advancing Private Sector Capacity, Competition and Investment*". An application has been made for Australian Research Council funding and the parties are awaiting the outcome of that application.

Although this research has not been formally arranged through the National PPP Council, it will be discussed in that forum. In view of this research, a separate independent study would not be justified.

Recommendation 20

The Victorian Government make representations to the National PPP Council to arrange for independent research to be undertaken on the degree to which discount rates should include a component for risk, and the size of this component.

Not Agreed

The Government believes its discounting methodology should take account of systematic risk. There are a number of different methodologies that can be used, and the discount rate is only one component of these methodologies. The Government is currently reviewing the available methodologies. At this stage the need for independent research arranged through by National PPP Forum has not been established.

Abbreviations:

AASB	Australian Accounting Standards Board
PAEC	Public Accounts and Estimates Committee
PPP	Public Private Partnership
PSC	public sector comparator
<i>PV</i>	<i>Partnerships Victoria</i>
VGPB	Victorian Government Purchasing Board