



Australian Government

Department of Infrastructure and Regional Development

# National Public Private Partnership Guidelines

## Overview



December 2008



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## Components of the Guidelines

National PPP Policy Framework

### **National PPP Guidelines Overview**

National PPP Detailed Guidance Material

- Volume 1: Procurement Options Analysis
- Volume 2: Practitioners' Guide
- Volume 3: Commercial Principles for Social Infrastructure
- Volume 4: Public Sector Comparator Guidance
- Volume 5: Discount Rate Methodology Guidance
- Volume 6: Jurisdictional Requirements
- Volume 7: Commercial Principles for Economic Infrastructure
- Roadmap for applying the Commercial Principles

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**Note:** This Overview is a summary of detailed guidance contained in other volumes and should be read in conjunction with those volumes.

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# 1 Introduction

## 1.1 The National PPP Guidelines

Australian Governments are committed to investing in infrastructure and delivering improved services to the community. Infrastructure investment is critical to our economic prosperity, and governments across jurisdictions currently seek the participation of the private sector in the delivery of infrastructure and related services to the public. Public Private Partnership (“**PPP**”) arrangements are one way of delivering infrastructure investment.

The National PPP Guidelines (the “**Guidelines**”) have been prepared and endorsed by Infrastructure Australia and the State, Territory and Commonwealth Governments as an agreed framework for the delivery of PPP projects. The Guidelines provide a framework that enables both the public and private sectors to work together to improve public service delivery through private sector provision of infrastructure and related non-core services.

The Guidelines describe a competitive and transparent mechanism to pursue opportunities that bring together the ideas, experience and skills of both sectors to develop innovative solutions to meet the community’s needs, expectations and aspirations.

The aim is to deliver improved services and better value for money, primarily through optimal risk transfer, management synergies, encouraging innovation, efficient asset utilisation and integrated whole-of-life asset management.

The Guidelines aim to consolidate the PPP guidance material of individual Australian jurisdictions to provide a unified national framework. The objective is to maximise the efficiency of infrastructure procurement, reduce public and private sector PPP procurement costs and remove disincentives to participation in the infrastructure market.

PPPs can make a valuable contribution to the delivery of infrastructure and services throughout Australia and are therefore encouraged, where appropriate, by governments across jurisdictions. The challenge for the public and private sectors is to determine the most effective and efficient means of service delivery in an arrangement that is beneficial to both sectors as well as to users and taxpayers.

### 1.1.1 Scope and application of the Guidelines

The Guidelines specifically refer to the provision of public infrastructure and related ancillary services through PPPs. Specific guidance on the definition of PPPs is provided in the *National PPP Policy Framework*. In general, however, PPPs involve the private sector delivery of infrastructure and related services. Examples of the type of projects for which a PPP framework has been used in the past include schools, hospitals and roads.

These Guidelines set a framework for the procurement of PPPs on a national basis and apply across State, Territory, and Commonwealth arrangements.

As a general principle, it is expected that a high degree of uniformity and agreement has been achieved in these Guidelines. However, specific requirements of individual jurisdictions, where different from or in addition to the Guidelines, will be detailed in *Jurisdictional Requirements Documents*.

## 1.2 Components of the Guidelines

The suite of publications comprising the Guidelines is as follows:

- National PPP Policy Framework
- National PPP Guidelines Overview
- National PPP Detailed Guidance Material
  - Volume 1: Procurement Options Analysis
  - Volume 2 : Practitioners' Guide
  - Volume 3 : Commercial Principles for Social Infrastructure
  - Volume 4 : Public Sector Comparator Guidance
  - Volume 5 : Discount Rate Methodology Guidance
  - Volume 6 : Jurisdictional Requirements

*Jurisdictional Requirements Documents* will provide details of individual jurisdictional requirements and will need to be read in conjunction with the Guidelines.

In addition, there is a *National PPP Policy Framework* that details the scope and application of the Guidelines across jurisdictions.

## 1.3 Updates

Updates to the *National PPP Guidelines* will be published, from time to time, on the *Infrastructure Australia* website ([www.infrastructureaustralia.gov.au](http://www.infrastructureaustralia.gov.au)).

## 2 Understanding PPPs

The Guidelines focus on using PPP procurement, where applicable, to gain value for money, including through whole-of-life costing, managing risk and protecting the public interest. Governments within jurisdictions will generally retain delivery control of Core Services.

PPPs create long-term contractual obligations, sharing risks and rewards between the private and public sectors. They therefore require careful consideration and approval by government.

### 2.1 Defining a PPP

#### 2.1.1 Overview of a PPP

A PPP is a long-term contract between the public and private sectors where government pays the private sector to deliver infrastructure and related services on behalf, or in support, of government's broader service responsibilities. PPPs typically make the private sector parties who build infrastructure responsible for its condition and performance on a whole-of-life basis.

PPP projects cover economic and social infrastructure and typically include both a capital component and an ongoing service delivery component of non-core services.

The principal features of a PPP are:

- provision of a service involving the creation of an asset involving private sector design, construction, financing, maintenance and delivery of ancillary services for a specific period;
- a contribution by government through land, capital works, risk sharing, revenue diversion, purchase of the agreed services or other supporting mechanisms; and
- the private sector receiving payments from government (or users in economic infrastructure) once operation of the infrastructure has commenced and contingent on the private sector's performance in supplying the services.

PPP projects are part of a broader spectrum of contracted relationships between the public and private sectors to produce an asset or deliver a service. However, these Guidelines are intended to apply to the private provision of services for which there is a public infrastructure element and a private financing element.

These Guidelines do not refer to private investment in infrastructure in jurisdictions where government does not have a direct interest in the provision of public services. This form of private investment in infrastructure represents a significant proportion of infrastructure investment in Australia. An example would include investment that is financed solely by private companies for their own purposes (e.g. a gas pipeline between states, or roads built from a mine to a port).

These Guidelines do not cover procurement methods such as alliancing, managing contractor, outsourcing or traditional procurement methods where the private sector is also involved in delivering infrastructure or associated services.

## 2.1.2 Core and non-core services

Governments will generally retain responsibility for delivery of Core Services (although this will be determined on a jurisdictional basis). Core Services are those where governments have particular responsibilities to people using the service and the community (such as in health and education).

The 'related' non-core services which are included in the scope of private sector provision may encompass accommodation services arising out of the infrastructure, including building-related services such as maintenance, cleaning and security, and some support services.

The determination of core and non-core services will occur on a case-by-case basis at the early planning stages of each infrastructure project.

## 2.1.3 Asset / services balance

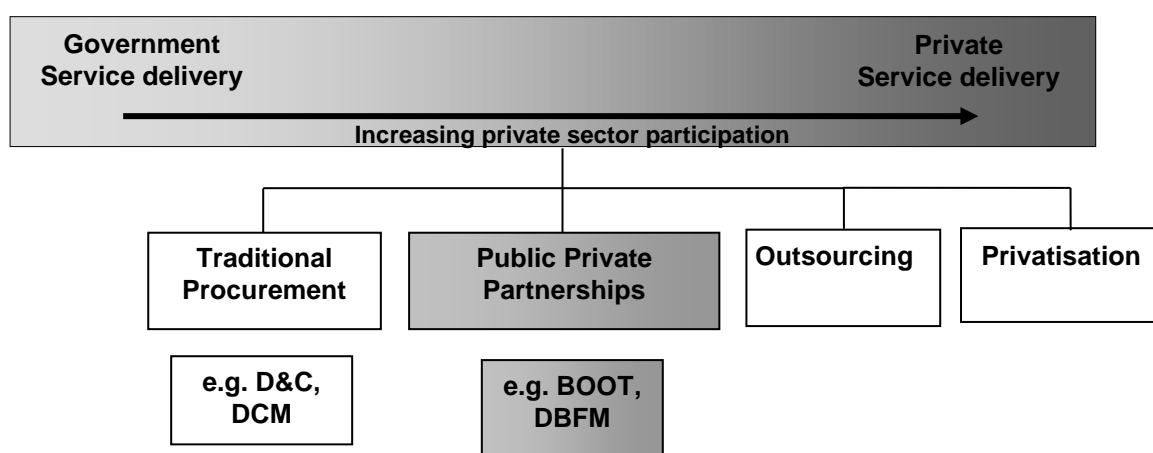
A PPP entails both the delivery of an asset and some services associated with the asset for a defined period. The balance of total project value between the asset creation and ongoing service delivery components may vary greatly from project to project. As such, a whole-of-life consideration of the asset and related services is crucial.

In a capital-intensive project, such as a toll road, asset creation is likely to dominate. In projects such as schools, courthouses, prisons and hospitals, the long-term service delivery component may be larger, even with the public sector providing Core Services.

## 2.1.4 PPPs are not privatisation

Importantly, private provision of infrastructure and non-core services does not mean privatisation, as governments will generally continue to deliver Core Services. Furthermore, asset responsibility under a PPP is generally transferred only for a specified period (with a range of specific requirements to be met at handback). *Figure 1* shows where PPPs are placed within the spectrum of private provision.

**Figure 1. Public and private sector delivery spectrum**





## 2.2 Key features of the PPP model

The PPP approach represents a shift in thinking from traditional infrastructure procurement methods. While many features of the PPP model are familiar from existing or past practice, there are key innovations and differences:

- **service focus.** The focus of PPPs is on purchasing services of an agreed quality and quantity and within an agreed timeframe. Purchasing services (rather than the asset directly) gives government greater strategic flexibility and focuses attention on the quality of the services being delivered. For this reason, the focus of PPPs is on services and performance, over the whole-of-life;
- **core services.** As discussed above, government itself generally retains direct control of certain core services. This is relevant particularly in social infrastructure projects;
- **payment for services.** The essence of the PPP approach is that government is buying services with an agreed quality, quantity, cost and timeframe. If a service is not provided on time or is not of agreed quality or quantity, service payments to the private sector party may be reduced.

Apart from exceptional circumstances, 'no service' should mean 'no payment'. This is consistent with a fundamental premise of PPPs being that the private party bears the risk of asset performance, while government has the certainty of paying only for those services it receives.

The government's capacity to control the quality of service delivery through the payment structure may depend on its control over demand for the services and the nature of that demand. To the extent that government makes some direct payments, there is scope for government to use the payment mechanism to directly achieve service quality outcomes.

In some cases, such as economic infrastructure, there is a user-pays arrangement, where payment to the private party similarly depends on users receiving a service (for which they then pay). Additionally, there may also be contractual obligations relating to performance which have financial consequences for the private party;

- **whole-of-life.** The PPP structure includes the full integration, under the responsibility of one private party, of up-front design and construction costs, with ongoing service delivery, operational, maintenance and refurbishment elements for the life of the contract;
- **financial discipline.** The participation of private finance instils a significant level of rigor and discipline;
- **output specification.** The output specification clearly sets out the outputs that government is seeking. The requirements should be expressed, as far as possible, in output terms and not in prescriptive input terms. Key to this is government detailing the required functionality of infrastructure, incorporating the overall services to be delivered;
- **value for money.** Value for money is a key principle of PPP projects and includes both a quantitative and qualitative assessment of the benefits of the private sector proposals. The quantitative assessment is assisted by the use of the Public Sector Comparator ("PSC") which is a whole-of-life net present cost model that reflects government retaining ownership and responsibility for construction/redevelopment and ongoing management of the project. The qualitative assessment looks at all other factors including certainty of delivery, quality, efficiency of design etc;
- **public interest.** The public interest is considered by government as part of the overall investment evaluation and subsequent procurement methodology decisions. Public interest matters continue to be important throughout the procurement and delivery of the infrastructure and associated services;

- **contract term.** PPP projects generally involve long-term contractual arrangements that combine the delivery of infrastructure assets. The term of the contract will be determined by reference to the optimal period for a whole-of-life approach with the ability to appropriately incentivise the private sector as well as the practicalities of debt funding;
- **contract management.** Given the long-term nature of PPPs, contracts need to be managed with a focus on the commercial relationship, long-term value for money and performance management; and
- **risk allocation and standard commercial principles.** These principles represent the preferred position of governments across jurisdictions in relation to risk allocations under a PPP model. The principles form the basis of contract terms for projects.

## 2.2.1 PPP differences with traditional procurement

Table 1 shows some of the key differences in procurement methodology.

**Table 1: Traditional Procurement and PPPs**

Traditional Procurement	PPPs
Government purchases an infrastructure asset	Government purchases infrastructure services
Short-term design and construction contracts (two to four years)	One long-term contract integrating design, build, finance and maintenance
Input-based specifications	Output-based specifications
Government retains whole-of-life asset risk	Private sector retains whole-of-life asset risk
Payment profile has a spike at the start to pay for capital costs, with low ongoing costs	Payments begin once the asset is commissioned. The payment profile is relatively even, reflecting the level of service provision over the longer term of the contract
Government is usually liable for construction time and cost overruns	Private contractor is responsible for construction time and cost overruns
Government operates the facility	Government may or may not operate the facility
Government manages multiple contracts over the life of the facility	Government manages one contract over the life of the facility
Often no ongoing performance standards	Performance standards are in place. Payments may be abated if services are not delivered to contractual requirement
Handover quality less defined	End-of-term handover quality defined

## 2.2.2 The range of PPP models

There is no preferred or standard model for PPP projects. For any given project, the model is determined by a number of factors, such as responses to questions about core services, value for money and the public interest.

The infrastructure projects implemented to date across jurisdictions cover a variety of industry sectors. Table 2 provides examples of PPP models used.

Table 2: Examples of PPP models

Model	DBFM	DBFO
Private party role	Infrastructure accommodation services and ancillary services	Infrastructure and service delivery to users
Government role	Delivery of core public services	No operational role
Infrastructure finance	Private	Private
Example	Hospitals, schools, prisons, courts	Roads

The objective is to achieve effective and efficient value for money outcomes. This must remain the aim, rather than a desire to promote any particular model.

The objective is to achieve effective and efficient value for money outcomes. This must remain the objective, rather than a desire to promote any particular model. A focus on the output specifications, the public interest, the capabilities of both the public and private sectors, optimal risk allocation and commercial viability, will indicate the most appropriate model for a particular project.

An important tool to determine the appropriate model is a Procurement Options Analysis. This is a document that analyses the appropriateness of various procurement methods for a particular project and provides guidance to help government decide on the most appropriate procurement method for the project. Further information on the Procurement Options Analysis is provided in *Section 3.1.2*.



## 2.3 Benefits of PPPs

For government departments and agencies, contracting the delivery of infrastructure and non-core services to the private sector creates opportunities to deliver improved public services more cost-effectively.

PPPs can potentially deliver significant benefits in design and the quality of services and the cost of infrastructure. PPPs can draw upon the best available skills, knowledge and resources, whether they are in the public or the private sector. Departments and agencies can focus their own efforts on the delivery of Core Services, and use the savings generated to improve or expand other services. PPPs can also bring forward infrastructure expenditure, including through delivering projects as part of a single package instead of staging capital development over the long term. .

PPPs also provide the construction, service and finance industries with opportunities to generate efficiencies and cost-effectiveness in the delivery of infrastructure and non-core services through innovation and specialist expertise, and to develop their businesses by doing so.

The PPP approach has a demonstrated ability to deliver value for money results for the community. Value for money from private sector involvement can be determined by governments through evaluating the project's costs and benefits.

## 2.4 The value for money drivers

The value for money drivers of PPPs include:

- **sufficient scale and long-term nature.** The project represents a major capital investment with long-term requirements;
- **complex risk profile and opportunity for risk transfer.** There is more rigorous risk evaluation and transfer to the private sector of those risks it is best able to manage, including those associated with providing the specified services, asset ownership and whole-of-life asset management.

A key implication of risk allocation is that government payment begins only when the output specifications are achieved. In practical terms, this occurs when commissioning tests have been passed. Moreover, PPP projects involve government having access to facilities or services. Payment is conditional on the private party achieving key performance indicators and may be abated in the event of failure to deliver;

- **whole-of-life costing.** There is full integration, under the responsibility of one party, of up-front design and construction costs with ongoing service delivery, operational, maintenance and refurbishment costs. This delivers improved efficiency through whole-of-life costing as design and construction become fully integrated up-front with operations and asset management.
- **innovation.** As the PPP approach focuses on output specifications, this provides a wider opportunity to use competition as an incentive for private parties to develop innovative solutions in meeting these service specifications. Opportunities may include:
  - bundled services, through a package deal for all non-core services;
  - upgrades, of associated and complementary infrastructure; and
  - packaged information systems.
- **asset utilisation.** Costs to government are reduced, through third party utilisation and

through more efficient design to meet performance (e.g. service delivery) specifications;

- **better integration of design, construction and operational requirements.** Ongoing service delivery, operational, maintenance and refurbishment responsibilities become a single private party's responsibility for the length of the contract period; and
- **competitive process.** The use of a competitive process helps to encourage the private party to develop innovative means of service delivery while meeting government cost objectives.

It should be noted that the accounting treatment of PPP projects is not a factor in the selection of the procurement methodology and is not considered a value driver.

## 2.5 Public interest matters

Governments will consider the public interest in all investment evaluation decisions and subsequent project procurement decisions. Each jurisdiction will have its own methods for considering public interest matters.

Considering public interest matters such as access, accountability and consumer rights is an important part of the PPP planning and project development. Ongoing monitoring of public interest matters during procurement will be useful in ensuring that the project continues to be in the public interest.

## 3 Determining PPP delivery

The key stages involved in any capital investment decision consist of:

- government approving the investment (and funding as required), as well as the preferred procurement method; and
- the procuring agency delivering the project under the chosen procurement methodology.

### 3.1 Key steps in the investment and procurement decision



Generally, the procuring agency will initially identify service-related infrastructure needs, then define specific projects and undertake a thorough analysis of the expected net benefits of the investment, which will inform the investment decision of government. In addition, departments and agencies will undertake an analysis of procurement methodologies to determine the most appropriate method, which in turn will inform the government's procurement decision.

#### 3.1.1 Identify service needs

Departments and agencies across jurisdictions are responsible for delivering particular services in line with their government's overarching service delivery goals and priorities and for ensuring that they have the necessary physical assets/infrastructure to achieve these goals. Infrastructure investment forms a key aspect of achieving government's service delivery outcomes.

Departments and agencies should undertake their asset/infrastructure planning within their government's overall framework. Where their asset strategy indicates that existing assets are insufficient to sustain appropriate service delivery levels, new capital works may be considered as a cost-effective option for service delivery.

While each jurisdiction will have its own asset management framework, typical aspects of the process will involve departments and agencies:

- defining their service/business outcomes, and ensuring that these are consistent with their government's goals, strategies and priorities, such as health, education, transport and metropolitan and regional development. They should examine opportunities for collaboration and integration of their strategic planning with that of other departments and agencies, where this will lead to better service outcomes for the community;
- considering what services are required and how these can be delivered sustainably within existing resource limits;



- considering demand management and non-build or less asset-intensive solutions to improve the efficiency and effectiveness of service delivery strategies;
- examining opportunities to improve the performance of their existing asset/infrastructure base (portfolio). They should ensure that assets align with service/business needs, asset-related risks to services are monitored and managed, existing assets are properly maintained and surplus assets are appropriately divested;
- identifying as far as practicable the performance based requirements for the infrastructure needed to sustainably support agreed service/business outcomes. Generally, these requirements would include social, environmental and economic parameters; and
- identifying financing options for asset management projects and programs.

Departments and agencies should plan new infrastructure investment only if the assets are required for service delivery and resources are likely to be available.

### 3.1.2 Project assessment and Procurement Strategy

A Business Case is commonly used across jurisdictions to support the investment decision. Also, a Procurement Options Analysis or strategy may be prepared to inform the government's procurement decision.

#### *The Business Case*

Each jurisdiction will have its own best-practice guidance for the development of a business case.

Some of the key items to be addressed in the business case which are particularly relevant to PPP procurement include:

- **project objectives and scope.** The business case should clearly articulate the objectives of the project and the scope of capital investment and services.
- **financial analysis.** A preliminary risk-adjusted net present cost financial analysis of the capital, maintenance, ancillary services and residual value must be conducted. This will fully cost the project to determine likely funding requirements and will form the basis of the PSC used later to provide a benchmark for assessing bids. This will include the full scope of the project, which may not be reflected in the Preliminary PSC. Data gathered and cash flows estimated during construction of a preliminary PSC will also assist the evaluation of whether the project would constitute a commercially viable business opportunity for a private party. The application and composition of the PSC in PPP projects across jurisdictions is further explained in *Public Sector Comparator Guidance*.
- **risk analysis.** The business case should identify all material risks associated with the project, specifying the external and project development risks for government, the project risks to be allocated to a private party and those to be retained by government. The business case should include at least a preliminary view on the cost to government of the risks which are to be built into the PSC.

#### *The Procurement Strategy*

Determining the procurement method is a critical step in the project delivery process. It is important to consider which method will best balance the control of project cost and risk against achieving project objectives and outcomes. The key issue is which form of project delivery provides the best value for money in meeting the government's service objectives.

In choosing the most appropriate method of delivery, some of the key issues to be considered include:

- **determining core versus non-core services.** As discussed above, Core Services are those which government has chosen to retain responsibility for delivering. Outside these, a range of asset-related and other ancillary services will be associated with the project and may be considered for inclusion in the scope of the private sector;
- **value for money.** Whether private sector involvement is likely to deliver value for money. The value for money drivers are used as the basis for this assessment.
- **analysis of market capability and appetite.** Government requires reliable data on which to base a decision on whether to offer a project to the market as a PPP project, or to deliver it by traditional means. This decision, which is based on practical grounds, requires an examination of:
  - whether private parties can deliver the project; and
  - whether they have the appetite or motivation to do so.
- **public interest.** Consideration of public interest matters associated with the proposed procurement approach.

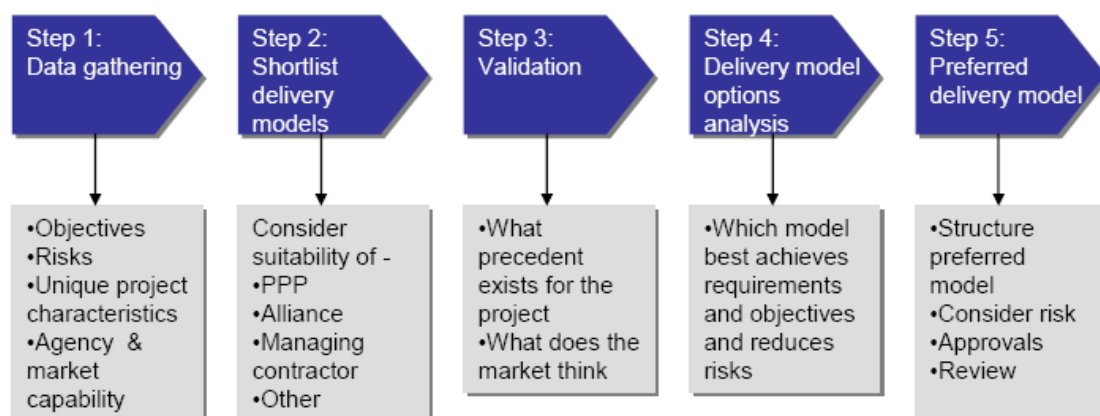
The Procurement Strategy will summarise these issues. It will include a procurement options analysis and will provide a recommendation to government as to the most appropriate procurement method.

Infrastructure projects are delivered through a variety of delivery models including:

- PPPs;
- alliance contracting;
- managing contractor model;
- construct only (lump sum or fixed price contract);
- design and construct;
- design, construct and maintain; and
- construction management.

Figure 2 outlines some of the key steps to be undertaken in selecting the most appropriate delivery model.

**Figure 2: Stages of selecting a delivery model**





### ***Challenges of the procurement selection process***

Optimal project outcomes are more likely to be achieved where an objective assessment of the most suitable procurement option is made based on the characteristics of the project. Key challenges include:

- **poor planning and risk assessment.** In some instances, poor project planning and/or risk assessment has resulted in inadequate consideration of key points required to ensure optimal project outcomes;
- **timeframe pressures emerging for projects.** Sometimes time pressures lead governments to make premature procurement decisions. Even where adequate consideration is given to procurement analysis, sometimes delivery timeframes can unduly influence procurement decisions;
- **market sentiment.** At various times, a certain method may be preferred either in the public sector or private sector. Procurement methodology should be selected based on the necessary upfront analysis and planning to ensure that the project is successful; and
- **focus not on value for money drivers.** Projects should be objectively assessed against all the feasible procurement options, and a decision should be based on the option that is likely to deliver the best overall project outcomes, rather than one which contractors prefer, or the department or agency can proceed with simply or quickly.

*Table 3* below sets out some of the key factors to consider in the various models.

Table 3: Suitability criteria and drivers of value

	When to use (e.g. suitability criteria)	Value for money drivers
<b>PPP</b>	<ul style="list-style-type: none"> <li>• Complex and long-term infrastructure projects</li> <li>• Outputs can be clearly defined and measured</li> <li>• Scope for innovation</li> <li>• Whole-of-life asset management is achievable and cost-effective</li> <li>• Strong market interest</li> <li>• Opportunities for appropriate risk transfer</li> <li>• Opportunity for bundling contracts</li> <li>• Significant service component</li> <li>• Complementary commercial development</li> </ul>	<ul style="list-style-type: none"> <li>• Sufficient scale and long-term nature</li> <li>• Complex risk profile and opportunity for risk transfer</li> <li>• Whole-of-life approach from integration of design, construction, operation and maintenance over the life of an asset, in a single project package</li> <li>• Innovation</li> <li>• Appropriate third-party use of facilities, reducing net cost to government</li> <li>• Efficiency of contract management</li> </ul>
<b>Alliance</b>	<ul style="list-style-type: none"> <li>• Complex and high-risk infrastructure projects</li> <li>• The solution is unclear or there is a significant likelihood of scope changes</li> <li>• A high level of innovation is required</li> <li>• Risks are unpredictable and best managed collectively, with costs of transferring risk prohibitive</li> <li>• The owner can be closely involved and add value</li> </ul>	<ul style="list-style-type: none"> <li>• Cost of adversarial conduct, claims and disputes is eliminated (e.g. the “no blame” culture)</li> <li>• Culture promotes innovation</li> <li>• Integrated planning, design and construction process with early contractor and consultant involvement</li> </ul>
<b>Construct Only</b>	<ul style="list-style-type: none"> <li>• The scope is defined and there is little likelihood of scope creep or wholesale changes to requirements</li> <li>• Little incentive or need for innovation from the contractor</li> <li>• It is desirable and there is sufficient time to complete design documentation before tendering</li> <li>• Limited opportunity for bundling services/maintenance and creating whole-of-life efficiencies</li> </ul>	<ul style="list-style-type: none"> <li>• Larger pool of potential tenderers which leads to increased competition</li> <li>• Greater scope for competitive prices because of design certainty</li> <li>• Contract value is set before construction starts</li> </ul>
<b>Design &amp; Construct</b>	<ul style="list-style-type: none"> <li>• The government’s requirements are tightly specified before tender or do not change</li> <li>• Government is best-placed to manage most project risks</li> <li>• Limited opportunity for bundling services/maintenance and creating whole-of-life efficiencies</li> </ul>	<ul style="list-style-type: none"> <li>• Single point of accountability for design and construction</li> <li>• Fixed price contract</li> <li>• Potentially, reduced overall project cost because the Contractor has the opportunity to contribute construction experience into the design, resulting in innovation and efficiencies</li> </ul>
<b>Managing Contractor</b>	<ul style="list-style-type: none"> <li>• Complex or high-risk projects with uncertain scope, risks or technology</li> <li>• A degree of expert government input is available</li> <li>• Early contractor involvement is beneficial</li> </ul>	<ul style="list-style-type: none"> <li>• Flexibility in delivery to manage uncertain risks</li> <li>• Maximising government input to manage risks where appropriate</li> <li>• Managing contractor is incentivised to achieve cost and schedule targets</li> </ul>

## PPP Suitability

Projects likely to provide value for money using a PPP delivery method are those with some or all of the following attributes:

- **long term.** Contracts tend to be long-term (up to/or more than 30 years), and reflect an acceptance of whole-of-life cycle costing risk by the private party;
- **measurable service outputs.** Government service requirements should have measurable outputs that can be translated to a performance contract. Payment mechanisms are generally structured around these output specifications to provide incentives for achieving key performance indicators;
- **innovation.** The project is sufficiently complex to encourage innovative approaches (in design and technology) that can deliver value for money;
- **whole-of-life costing.** Full integration, under the responsibility of one party, of up-front design and construction costs with ongoing service delivery, operational, maintenance and refurbishment costs. This delivers improved efficiency through whole-of-life costing as design and construction become fully integrated up-front with operations and asset management;
- **market appetite.** The project creates a genuine business opportunity which is likely to attract a sufficient number of private parties and create an effective and competitive bidding process;
- **opportunity for risk transfer.** A PPP project needs to be structured to achieve optimal risk allocation. Value for money is a key driver of PPPs and there needs to be scope to allocate appropriate risk to the private sector.
- **bundling of contracts.** In many cases, the provision of a service or capability by the public sector depends on a number of separate contracts with different contractors. PPPs provide an opportunity to combine related services and an asset into a single long-term contract;
- **non-core services.** Contracts are likely to include a requirement for a range of non-core services and support activities to be delivered that currently divert management and skilled staff in the public sector. These services may include accommodation availability, information technology outputs and many other services; and
- **complementary commercial development.** The commercial opportunities that may add value to the project and/or reduce service payments to the private party (where complementary to the project objectives).

Together, these characteristics can create cost savings for government in the competitive bidding process, while giving an opportunity for innovative service delivery and a viable opportunity to the private sector (where complementary to the project objectives). The value-for-money outcomes can produce both quantitative value (through cost savings) and qualitative value (enhanced built environment, environmental achievements and improved contract management disciplines).

While the presence of these characteristics will not always mean that PPPs are a viable or the most appropriate option, their presence does suggest that PPP options should be properly considered as part of any Procurement Options Analysis undertaken.

### **3.1.3 Government approval of the investment and procurement**

Prior to a project being delivered, government will approve the project (and funding as required), as well as the preferred procurement method, which may be a PPP. Governments in individual jurisdictions will have their own processes for procuring agencies to follow in order to obtain government approval for the investment (and/or funding), and whether this should occur simultaneously with (or before) a decision on the preferred procurement method.

## **3.2 Unsolicited proposals**

Unsolicited proposals and exclusive mandates can provide a source of innovative ideas about how to improve the delivery of government services. Given their unsolicited/exclusive basis, as a general principle such proposals need to demonstrate unique value for money benefits that allow the government to demonstrate with confidence the reasons for entering into an exclusive arrangement rather than a competitive tender process. Further, as with all projects, unsolicited proposals must demonstrate an overall community benefit and be consistent with the government's plans and priorities.

Commercial viability alone will not be sufficient to gain the government's support.

This is an area where government departments and agencies should seek further advice from the relevant PPP Authority. Each jurisdiction will have its own policies and procedures for dealing with unsolicited proposals/exclusive mandates.

## **3.3 Delivery as a PPP**

Once government has approved the project to proceed (investment decision) and be delivered as a PPP (the procurement decision), the procuring agency is responsible for delivering and managing the project. It is common that government makes an announcement associated with these decisions.

The following sections focus on the process for delivering the project once government has decided to approve the project on the basis that it is delivered as a PPP.

## 4 Delivering a PPP project

### 4.1 Key principles underpinning a successful PPP

PPP contracts are long-term and the relationship between all the parties is critical. Sustaining this relationship depends on the willingness of the parties to cooperate where appropriate to resolve matters. The partnership also depends on creating a genuine, sustainable business opportunity for the private party.

The key principles to be observed throughout the PPP process to create a successful project are:

- **planning and specification.** How carefully the requirements of the project are developed before the project is put to the market directly relates to the efficiency of the bid process and the quality of the result. The focus should be on the outcomes that government is looking to achieve and specifying the outputs required to achieve them. This is very important, because how outputs are defined will affect the opportunities of private parties to be innovative in designing their inputs to achieve government service outcomes;
- **project resourcing.** Appropriate resourcing is critical to a project's success. This includes identification and selection of a project team that has the requisite skills and the appointment of specialist advisors where required. A strong project team is required to ensure the process runs efficiently and without unnecessary cost, in line with the required timelines, to protect the government's interests and to deliver value for money outputs;
- **business opportunity.** The commercial structure of the project must provide a viable business opportunity for private parties who are able and willing to manage the opportunities and the risks inherent in providing the required outputs;
- **probity.** The process is to be managed according to well-developed probity principles and a probity plan (discussed in more detail in the Practitioners' Guide);
- **invest time in development of the process and tender documents.** Sufficient time needs to be invested in developing a well-thought-through process and high-quality tender documents;
- **timeline management.** The Tender Process must be carefully managed to ensure adherence as far as possible to agreed timelines. Failure to meet critical dates increases bid process risk and is inefficient for both government and the private sector;
- **certainty of process.** The private sector must be provided with a precise description of what is required and the hurdles that need to be cleared if government is to proceed with the project;
- **clarity of communication.** The clarity and effectiveness of communication throughout the process is critical to ensuring a common understanding of the requirements and the maximisation of the opportunity to provide a value for money outcome;
- **maintaining competition in the tender process.** The process needs to encourage strong competition between private parties to drive value for money outcomes for government;

- **achieving value for money.** Achieving value for money is a key requirement of government and is a combination of the service outcome to be delivered by the private sector and the degree of risk transfer and financial implications for government;
- **minimising bid costs where practicable.** Governments are aware of the need to balance the requirement for a competitive bidding process for PPP projects with the costs of participating in that process. Governments aim to minimise these costs where practicable and the development of these Guidelines is one aspect of streamlining processes;
- **bid evaluation.** The evaluation criteria need to clearly articulate the key issues for consideration and the submission requirements need efficiently to request the information that is needed to enable Government to evaluate proposals. The focus needs to be balanced across all key elements of the project and the financial aspects;
- **recognition of the partnership.** This encourages good faith and good will between government and the private party in all dealings; and
- **contract management.** The process needs sound contract management arrangements, including early involvement of those responsible for administering the contract.

## 4.2 Government approvals

There are a number of milestones in the PPP process at which governments typically seek to approve various actions before the project proceeds to the next phase (see Figure 3). In particular, these key project milestones involve:

- release of EOI;
- release of RFP;
- selection of a preferred bidder; and
- execution of the contract.

Governments may also wish to be notified of and/or endorse the outcomes at the selection of the shortlisted bidders following the EOI phase.

Additional approvals are likely to be required where:

- there is a material change to the project including an amendment to the key project objectives, scope of services or where the conclusions or major assumptions of the Business Case (including the economic and financial appraisals) significantly change;
- there is any material change in the risk allocation from that which was last approved by government;
- an amendment to the budget funding is required; and
- issues relating to the public interest arise.

Furthermore, if the procuring agency wishes to renegotiate any area of a PPP contract after it has been approved and signed by government, the agency may also be required to obtain approval from the relevant PPP authority before renegotiating.

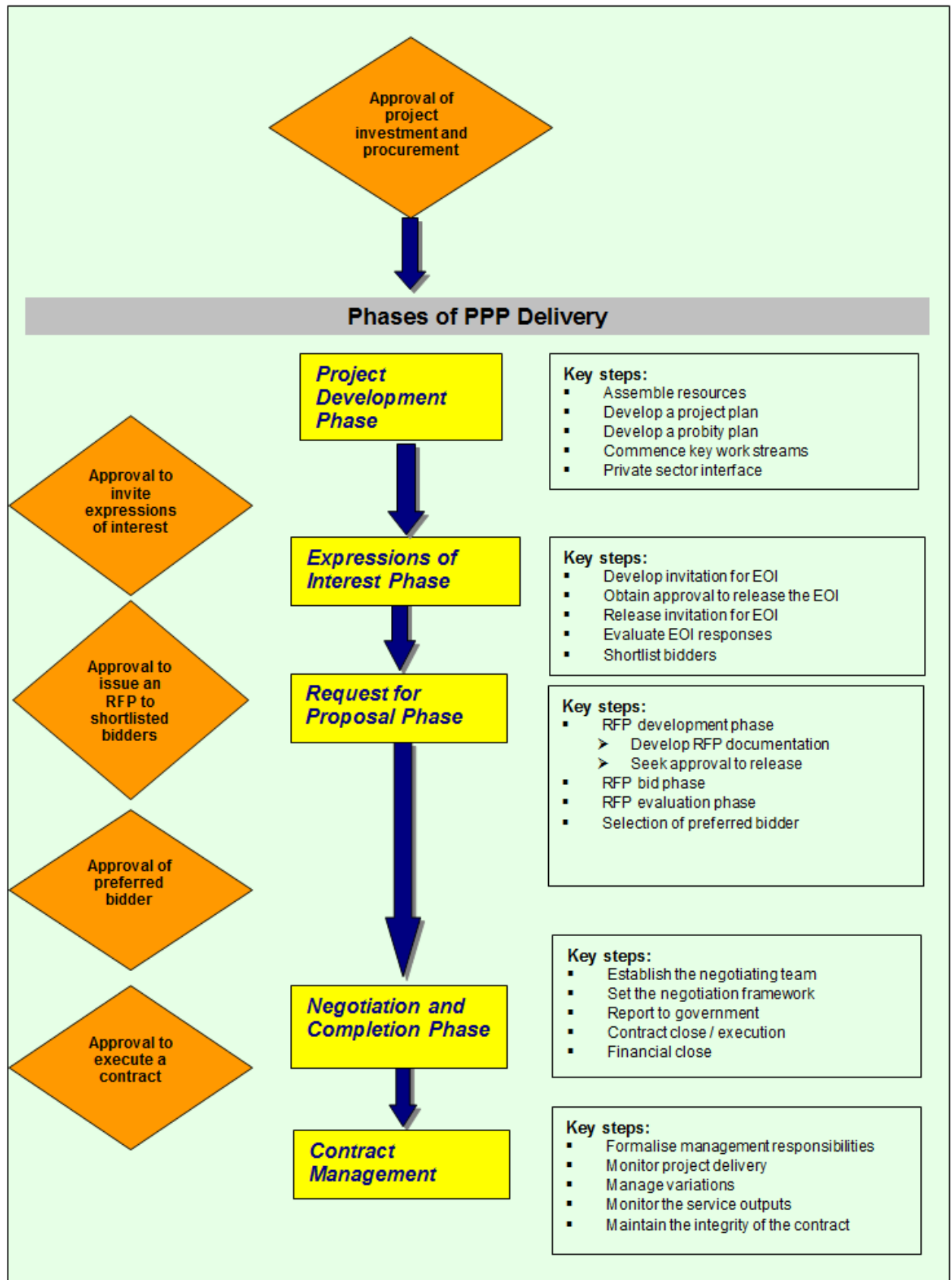
## 4.3 Key phases in the delivery of PPPs

Following government approval of a PPP project, the process that a procuring agency should implement is set out in detail in the *Practitioners' Guide*.

Most projects will progress through the process outlined in the *Practitioners' Guide*, for consistency both in government processes and in how projects are put to the market. However, there may be circumstances in which government decides that a project is to be developed through a different process. In such cases, it is important to ensure that all interested parties, particularly private parties, are made aware of the variation and that the varied process is clearly communicated and maintained.

This section provides an outline of the process of delivering a PPP project, and figure 3 sets out the key phases involved.

Figure 3 Phases of PPP delivery





### 4.3.1 Project development

Following endorsement of the project by government as a PPP, the project is further developed. This will require the assembly of resources and the development of the project structure and commercial principles in readiness for seeking formal market interest. Key aspects during the project development phase include:

- **assemble resources.** The complexity and scale of PPPs require a team-based management approach to ensure all required skills are effectively applied. The appropriate resourcing of a project is critical to its success. For PPP projects, the specialist expertise required for the project includes commercial, financial, technical, operational and legal skills. The exact skills and experience required will vary depending on the nature of the project. Special consideration may be required to ensure sufficient resources are available to fill specialist roles. It is critical to identify the time commitment required from key advisors in the PPP process. Key roles also include:
  - a project director responsible for delivery of the project;
  - a project steering committee to direct the development of the project and deal with key issues; and
  - a dedicated project team to develop and implement the PPP project, comprising commercial, financial, legal, and technical expertise.
- **project plan and timetable.** A clear project plan not only dealing with tender timetable but also allowing for review processes (such as 'Gateway' type reviews), environmental and planning approval processes and any community consultation;
- **probity plan.** At this point, a probity practitioner should be appointed, to assist in the development of a probity plan that is endorsed by the project steering committee. The probity practitioner will also assist in developing processes to ensure the probity principles outlined in this plan are followed and communicated to the relevant stakeholders;
- **commence key work streams.** Further development of the design requirements, operational and service requirements, key commercial principles, preliminary risk allocation and work of the PSC; and
- **private sector interface.** Engagement with the private sector on matters such as scope, timelines, market interest and capability.

### 4.3.2 Expression of Interest ("EOI") Phase

The EOI phase is the first step in the formal bidding process. The purpose of the invitation for EOI is to:

- formally advise the market of the project and the services that government seeks to have delivered;
- communicate to the market the proposed timeframes, evaluation criteria and hurdles to be met for the project to move forward;
- confirm the level of market interest in the project and provide an avenue through which private parties can comment on the proposed project structure; and
- obtain EOI responses from the market which allow government to shortlist a number of private parties to proceed to the RFP phase who are most capable of delivering against the project objectives over the project term.

Key aspects during the EOI phase involve:

- **develop the EOI documentation.** This document should include important information about the project, information to help market participants respond and the criteria that will be applied to evaluate EOI responses; and
- **evaluate and shortlist.** This process will involve evaluating the EOI responses, in accordance with the evaluation criteria and a pre-approved evaluation plan, to ultimately choose a number of shortlisted bidders who will proceed to the RFP phase. The shortlisted bidders generally include three parties to ensure adequate competition is created and the risk of a party withdrawing is covered. Certain instances (such as the presence of related-parties bidding or a specific need to increase competitive tension) may require a shortlist of more than three. However, this can potentially lead to some shortlisted bidders losing interest, as the chance of success may not warrant the significant investment of time and resources in preparing a bid. In instances where there are only a limited number of private sector parties capable of bidding, a shortlist of fewer than three bidders may be appropriate.

### 4.3.3 Request for Proposal Phase (“RFP”)

The RFP phase involves the release of the RFP and evaluation of RFP responses to select a preferred bidder. Key parts of this process involve:

- **RFP development phase.** Broadly the RFP will comprise:
  - general information conveyed to shortlisted bidders about the project background, the tender process, the evaluation criteria, and the required format for responses;
  - the output specification which clearly details the outputs that the procuring agency is seeking;
  - the payment mechanism and performance requirements (particularly relevant for social infrastructure projects);
  - commercial framework summary of the proposed risk allocation and key commercial principles;
  - the contractual documentation which sets out the terms and conditions on which government proposes to undertake the PPP; and
  - the evaluation criteria and proposal schedules.
- **compilation and finalisation of the PSC;**
- **assisting shortlisted bidders during the RFP ‘bid’ phase through an interactive tender processes.** An interactive tender process provides shortlisted bidders with an opportunity to discuss the development of their concepts and designs and to seek clarification and feedback in the context of the government’s output requirements prior to lodgment of RFP responses (refer *Section 4.4.4 of the Overview*);
- **the RFP ‘Evaluation’ phase.** This involves evaluating the RFP responses against the evaluation criteria as outlined in the RFP. Key aspects will involve determining the comparative value-for-money of each proposal with consideration of qualitative and quantitative aspects; and

- **selection of a preferred bidder.** The evaluation of proposals will identify a preferred bidder with which it is intended to negotiate and execute binding contractual arrangements. Depending on the outcomes of the evaluation process, it might be necessary to undertake a further shortlisting process to determine a preferred bidder, possibly through a best and final offer, or a structured negotiation process e.g. if there are material outstanding issues and/or there would be material benefit to government in retaining competitive tension.

### 4.3.4 Negotiation and Completion Phase

Once a preferred bidder has been identified, plans should be made to move the contract negotiations forward as quickly as possible. Key aspects in this phase include:

- **setting the negotiation framework.** The negotiation team led by the project director sets a framework for contract negotiations;
- **executing the contract.** Once the approval process is complete, the contract is awarded to the successful private party; and
- **reaching financial close.** At contract execution there may be a small number of matters that financiers need to resolve before unreservedly committing their finance to the project. Following financial close there is also likely to be a range of review and disclosure requirements.

### 4.3.5 Contract management

Following financial close, a typical PPP has several distinct stages:

- **construction stage.** From the time construction (or implementation) starts through the commissioning process to the start of payments when delivery of the services required by the output specification begins;
- **service delivery (operational) stage.** Covers the provision and use of the contracted services during the remaining life of the contract; and
- **Contract expiry or termination stage.** The period leading up to and after contract expiry or termination.

Effective contract risk management requires the dedication of appropriate financial resources and experienced personnel to the establishment of a contract risk management strategy during the procurement phase of the project and the maintenance of that strategy throughout the project lifecycle.

Key contract management principles commonly applied in PPP arrangements include:

- **planning, information collection and analysis.** This includes planning the contract management strategies that will be used for the project to assist in determining the information that will be required to implement those strategies. The information collected and analysed will help refine the contract management plan and help government to identify, understand and manage project risks;

- **contract administration.** Contract administration requires an understanding of the legal documentation for the project and also:
  - the technical ability to manage the contractual requirements;
  - the commercial intent of the parties;
  - the operating, industry and community issues associated with service provision; and
  - the legislative and regulatory context in which the project operates.
- **performance reporting and monitoring.** PPP projects, by their nature, experience high levels of change. In a well-managed PPP project, government can sensibly control this dynamic situation because it has access to adequate information on which to base 'control' actions;
- **relationship management, dispute resolution and issue management.** Given the long duration of PPP projects, it is imperative to maintain a strong relationship between government and the private party;
- **governance, probity and compliance.** Proper management of a PPP project by government involves not only managing the contract and relationship with the private party, but also ensuring appropriate governance, probity and compliance practices are established within government and in its interactions with the private party and any other government stakeholders;
- **knowledge and information management.** The government's ability to successfully manage a contract can depend upon the contract director having an effective knowledge and information management strategy tailored to the project's needs;
- **change management.** During the lifecycle of a PPP project, it is likely that a number of changes will occur, requiring proper management;
- **contingency planning.** Contingency planning for government is vital to a PPP project because it may not be possible to transfer fully responsibility for the risk of service delivery failure to the private party, and may be compelled to continue the supply of affected services; and
- **ongoing review.** Contract management processes must change and adapt throughout the lifecycle of a PPP contract, and therefore should be reviewed on an ongoing basis to ensure that management is sufficiently informed of current and emerging risks and issues.

Further information on contract management is provided in the *Practitioners' Guide*.

## 4.4 Key issues to consider as part of developing the PPP

### 4.4.1 Probity and integrity

Governments are committed to efficiency, fairness, impartiality and integrity in all dealings. Probity is an important issue for government as a custodian of the community's assets. PPP transactions can involve a lengthy and complex tender process. Good process and probity are consistent with achieving value for money in commercial engagements. Probity management is an integral part of the process, not a separate obligation.

Key aspects include:

- ensuring conformity to the process;
- ensuring principles of openness, fairness, and transparency are maintained throughout the process; and
- ensuring public and bidder confidence in the process.

As part of addressing probity concerns, PPP projects will often have:

- **a comprehensive probity plan.** A well-crafted probity plan that helps foster a probity culture and spells out proper process will result in the demonstration of the equity of the process and also assist in the efficient achievement of project objectives; and
- **a probity practitioner.** The role of the probity practitioner is to provide independent assessment and/or ongoing advice throughout the tender process, provide appropriate sign-off at designated milestones and provide necessary reports.

Key probity issues include:

- ensuring confidentiality during the commercial engagement process. This protects both the competitive position of individual private parties and the commercial interests of departments and agencies. As part of this, clear security procedures will be required for handling tender-related documents (produced by both private parties and the department or agency); and
- ensuring intellectual property is protected in the formal bid processes and discussions around projects. This involves:
  - the identification of intellectual property;
  - treatment of intellectual property contained in formal bid documents; and
  - the manner of dealing with intellectual property in contractual arrangements.

Intellectual property commonly encountered in PPPs includes:

- designs, drawings etc. relating to the construction of infrastructure and assets;
- technology associated with the delivery of services (e.g. technical solutions for more efficient treatment of waste water). Such technology is usually governed by some form of licence in any event; and
- operational processes for the delivery of outputs.

It is important to note that a project's probity requirements are not intended to inhibit communication with bidders throughout the tender process but are simply to ensure that the above principles and issues are appropriately addressed.

Further information on probity issues is provided in the *Practitioners' Guide*.

### 4.4.2 Conflict of interest

A conflict of interest (COI) arises where a member of, or an advisor to a project team has an affiliation or interest which might be seen to prejudice their impartiality. If a COI exists (whether actual, potential or perceived) the project director must undertake a risk assessment and determine the appropriate approach to protecting the interests of government.

A three-question test determines whether a COI exists and whether further risk assessment or immediate remedial action is required. The test aims to establish whether the interests of government and the competitive process could be compromised by this event, and involves:

- might the person's other duties result in the individual compromising their obligation to government (e.g. conflict of duty)?
- does the person have the ability to compromise their obligation to government by accessing information that may benefit themselves or other parties?
- could the person compromise the interests of government and their obligation to it by potentially influencing or altering the outcome to government in a material way that will benefit the person or other parties?

Disclosures should be directed initially to the project director who then reviews the disclosed situations in consultation with the probity practitioner, legal advisers, the project steering committee, and senior government officials as needed.

Further information on conflict of interest is provided in the *Practitioners' Guide*. Also discussed in the *Practitioners' Guide* are related party probity principles.

### 4.4.3 Disclosure principles

Government decisions on disclosure must weigh up whether the public interest is met in maintaining confidentiality during a tender process or is met by disclosure. Confidentiality is particularly important during the RFP phase where confidential and sensitive commercial information is supplied by shortlisted bidders and the disclosure of cost structures would disadvantage the competitive process.

Governments may release the contract and a summary to the public following financial close that may include the background to the project and a summary of the key contractual terms and conditions.

A post-implementation review is also often undertaken on PPP projects. Where employed they will be a valuable tool in refining the processes used in developing PPP projects and are generally undertaken jointly by the procuring agency and the relevant PPP authority.

Further detail on disclosure principles is in the *Practitioners' Guide*.

#### 4.4.4 The Interactive Tender Process

The interactive tender process involves government holding a series of individual workshops with shortlisted bidders during the RFP 'bid' phase. Interactive workshops are conducted in accordance with the probity framework.

An interactive tender process provides shortlisted bidders with an opportunity to discuss the development of their concepts and designs and to seek clarification and feedback in the context of the government's output requirements, before lodgment of bids.

The objective is to improve the quality of bid submissions, and ultimately deliver better outcomes for the public, through clear communication of the government's requirements to ultimately influence the overall quality of RFP responses received from shortlisted bidders.

An interactive tender process may be appropriate to use where there is a high level of interface risk between government (as operators) and the private sector infrastructure providers (such as with social infrastructure projects). Generally the following types of interactive workshops are offered:

- technical workshops dealing primarily with design and development approval issues;
- services workshops; and
- commercial, legal and/or financial workshops.

An important consideration is to involve technical specialists in these workshops. The RFP should specify the procedures, timetable and protocols for the interactive tender process.

Further information on the interactive tender process is provided in the *Practitioners' Guide*.

## 4.4.5 Taxation and Accounting Issues

### *Taxation Issues*

Commonwealth taxation law has undergone substantial review and reform since the commencement of the Ralph Review of Business Taxation (RBT) in 1998. While projects are taxed at the National, State and Local Government levels, (Commonwealth) income taxation is generally the most significant tax cost to the private parties involved in, or considering, large infrastructure projects under PPP arrangements. Accordingly, government officers seeking to establish the potential viability of a project, or involved with the evaluation of bids, require a sound working knowledge of relevant taxation provisions (or access to such knowledge).

Taxation considerations are important in PPP arrangements and should be subject to careful and expert analysis throughout the procurement process. Given the complexity of most taxation issues applicable to PPP arrangements, both the procuring agency and bidders should be supported by professional tax advisors.

Further details on taxation issues are provided in the *Practitioners' Guide*.

### *Accounting Issues*

The accounting for PPP projects is complex and does not easily fall within the existing scope of commercial arrangements considered under the current Framework of the Australian Accounting Standards Board (AASB).

Generally, Treasury and/or Finance departments across jurisdictions are responsible for accounting policy guidelines and should be consulted by the procuring agency when the accounting treatment for any particular PPP transaction is being considered.

Further details on accounting issues are provided in the *Practitioners' Guide*.



## 5 Risk allocation and commercial principles

### 5.1 Overview

To achieve value for money, risks are allocated to the party best able to manage them. This ensures that the cost of managing risk is minimised on a whole-of-life and whole-of-project basis.

A full risk analysis should be undertaken for all PPPs. This involves comprehensive risk identification, assessment, allocation and mitigation strategies. This process generates information which is used, among other things, in the construction of the PSC, evaluation of value for money, determination of the payment mechanism, the development of risk management plans and in determining the contractual terms and conditions.

While it is desirable for government to adopt a standardised risk approach to minimise transaction costs, risks should ultimately be considered on a case-by-case basis, taking into account the unique characteristics of each project and the current state of markets.

The risk allocation and commercial principles for a social and an economic infrastructure project may differ markedly particularly in market risk allocation, treatment of force majeure events, default and termination events and compensation events. Optimal risk allocation

By adopting a service focus and paying only for services received, PPPs presuppose that the private party bears the risks associated with designing, building and operating the infrastructure, including the risk of obsolescence and/or residual value. From this starting point, to achieve value for money, government takes back those risks that it can manage for less than it would have to pay the private party to bear.

Optimal risk allocation seeks to assign project risks to the party in the best position to control them and therefore minimise both project costs and risks. The party with greatest control of a particular risk has the best opportunity to reduce the likelihood of the risk eventuating and to control the consequences if it does.

Thus, for both pricing and management reasons, optimal risk allocation dictates that particular risks are allocated in line with capacity to control and manage risk at least cost. The risk allocation process results in various risks being:

- retained by a government;
- transferred to the private sector; or
- shared by the parties.

Although many risks are in the control of each party, to some degree certain risks are outside the control of both parties. If neither party is in a position of full control, the risk allocation should reflect how the private party prices the risk and whether it is reasonable for government to pay that price, taking into account the likelihood of the risk eventuating, the cost to government if it retained that risk and the ability of government to mitigate any consequences if the risk materialises.

In relation to shared risks, it is important to note that the sharing may not be on a 50:50 basis, but split in some other way. For example, government and the private party may adopt the use of caps on risk exposure, time thresholds, defining specific events and using a schedule of rates. Risk sharing can also use a predetermined mechanism where the parties can act together to mitigate and share the consequences of the specified materialised risk.

Allocating risks in this context generally refers principally to transferring the financial consequences of risk events, rather than the risks themselves. Ultimately the risk and responsibility for the delivery of public services stays with government.

Where payment for the service is not made by government but by the end-consumer, the private party may be able to mitigate a materialised risk by passing through any additional costs to the end-users. Any passing through should be subject to appropriate contractual restrictions and may be subject to a regulatory regime which ensures that the level of pass-through is justified.

## 5.2 Risk allocation and the payment mechanism

The payment mechanism is at the heart of social infrastructure PPPs, as it puts into financial effect the allocation of risk and responsibility between government and the private party. It determines the payments that government makes to the private party and establishes the incentives for the private party to deliver the service required in a manner that gives value-for-money.

Key features of the payment mechanism should include:

- no payments should be made until the contracted service is available. For example, in a water treatment project, no payments would begin until the plant has been commissioned and water of the required quality is being received;
- there should be a unitary charge for the service, not separate charges for elements relating to availability or performance;
- the unitary charge should be paid only to the extent that the service is available (e.g. proportionate to the number of available places or units);
- the payment mechanism should allow abatements for sub-standard performance so that the private party's financial motivators coincide with those of government;
- abatements should reflect the severity of failure, so that no service should lead to no payment, but a minor failure to a lower level of deduction. However, in some circumstances (for example, a package of schools), unavailability of one whole facility (school) may result in no payment for that one facility rather than no payment for the whole package;
- performance measurement should be linked to an agreed set of standards or key performance indicators which generally will relate to quality, timeliness or other service delivery requirements; and
- arrangements should allow government adequate flexibility to require, and reward, changes in the nature or volume of services to be delivered over time.

## 5.3 Risk allocation and the PSC

To reflect properly the costs of government delivery, a PSC should include both the value of those risks that would be retained by government under a PPP and those that would be transferred to the private party. Pricing both of these risk categories can help to determine whether risks should be assumed by government, rather than government paying a higher price for their allocation to the private party.

For social infrastructure, the expected costs/benefits of risks should be included in the cash flows of the PSC. To value risk, an estimate should be made of both the likelihood of the risk occurring and the dollar impact of the risk if it did eventuate.

For economic infrastructure projects, the construction of the PSC is developed on a project finance basis. PSCs for economic infrastructure projects generally will incorporate the following principles:

- commercial capital structure, for example a level of debt and equity that optimises the value of the project while maintaining an investment-grade credit rating for the project's debt. Prudential constraints will be applied to the project's financial structure, including minimum debt service cover ratios and reserves for debt service;
- debt guarantee, reflecting the margin between the project's credit rating and the AAA-rating of the Government; and
- commercial level of return on the Government's equity investment in the project, reflecting the project and financial risks borne by equity throughout the project's life.

## 5.4 Key areas of risk allocation

The following section provides details on some of the key risks that may arise as part of a PPP project. Specific guidance on the commercial principles and risk allocation in relation to these and other items is provided in the *National Commercial Principles for Social Infrastructure*.

### 5.4.1 Key Risks

The following table identifies some of the key risks that are applicable to PPP projects:

Risk	Description
Site risk	This includes the risk that the project land will be unavailable or unable to be used at the required time, or in the manner or at the cost anticipated, or the site will generate unanticipated liabilities.
Design, construction and commissioning risk	This is the risk that the design, construction or commissioning of the facility (or certain elements of those processes) is carried out in a way that results in adverse consequences for cost and/or service delivery.
Sponsor risk	In establishing a project consortium, the sponsor typically establishes the private party in the form of a special purpose vehicle ("SPV"), which contracts with government. The SPV is simply an entity created to act as the legal entity of a project consortium. Because the arrangement is financed through non - recourse or limited recourse debt, creditors have access to the project's cash flows but limited-recourse to the sponsors' balance sheets. Sponsor risk is the risk taken by government that the SPV, or its subcontractors, will not fulfill their contractual obligations.

Risk	Description
Financial risk	This includes the risk that private finance will not be available, the project will not prove financially robust or changes in financial parameters will alter the bid price before financial close.
Hard and soft facility maintenance operations risk and the payment mechanism	This includes the risk that payments made for services during the service period are abated due to performance incidents and is typically reflected in both the contractual provisions and the payment mechanism. The larger the size of hard and soft facility maintenance service packages, the more effective is the payment mechanism in influencing service performance.
Market risk	This includes the risk that demand or price for a service will vary from that initially projected so that the total revenue derived from the project over the project term will vary from initial expectations.
Network and interface risk	This arises where the contracted services or method of delivery of those services are linked to, rely on or are otherwise affected by certain infrastructure, inputs and other services or methods of delivering the contracted services. Interface risk is the risk that the contracted services will not be compatible with the delivery of Core Services.
Industrial relations risk	This is the risk that industrial action impacts on the performance under the contractual obligations.
Legislative and government policy risk	This is the risk that government will exercise its powers and immunities, including but not limited to the power to legislate and determine policy, in a way which disadvantages the project.
Force majeure risk	This refers to the risk that events may occur which will have a catastrophic effect on either party's ability to perform its obligations under the contract.
Asset ownership risk	This includes the risk of maintaining the asset to the requisite standard (including the risk that the cost of maintenance may increase during the term), the risk of premature obsolescence, or that the construction of competing facilities will occur.
Tax risk	This is the risk that changes in the taxation framework may impact on the financial assumptions of the project.
Interest rate risk	This is the risk of adverse interest rate movements.

### 5.4.2 Social vs Economic infrastructure

Although the majority of the risks identified above will be applicable to both social and economic infrastructure projects, the allocation of risk between government and the private sector may be materially different.

An economic infrastructure PPP typically involves a 'user-pays' structure rather than a service charge structure which is most often relevant to social infrastructure. Typically, the user-pays structure involves the payment of tolls, fares or user charges for the use by the public or by the business community of facilities such as roads, bridge, tunnels and potentially, ports, airports and trains/trams.

Generally, the revenues earned through user charges are expected to be sufficient to enable the private party to repay the debt raised to fund construction of the facility, meet operating costs, pay the interest on the debt raised and give the required equity return.

In contrast, a social infrastructure project is generally availability-based and reliant on direct payment from government. These differences drive a different ability to manage, and therefore optimally allocate risk.

## 5.5 Key commercial principles

Specific guidance on key commercial principles is provided in the *Guidance Commercial Principles for Social Infrastructure*.

Reflecting the risks identified above, a range of key commercial principles are applied to a PPP project. Specific examples include:

- **payment mechanism and availability.** An underlying principle of social infrastructure PPPs is that there is a unitary regular payment to the private party for making the infrastructure available and for providing the contracted services. Government should pay for the infrastructure only to the extent that it is available and should abate the fee to the extent that the services are not performed to the required standard;
- **insurance.** Consistent with the transfer of asset ownership risk to the private party, the private party is often responsible for obtaining and maintaining insurances required by law and the minimum insurance requirements specified in the project agreement. If a risk becomes uninsurable after financial close, the private party will not be required to procure insurance for that risk as long as that risk remains uninsurable;
- **relief, compensation and force majeure events.** The private party may be able to receive relief from its obligations and/or compensation if certain adverse events occur. Broadly such events may include: natural disasters; fire; certain breaches of contract by government; government-initiated modifications; changes in certain types of laws; certain industrial disputes/actions and certain legal proceedings or court actions;
- **default events.** Depending on its severity, a default may be subject to a project default regime, a persistent breach regime (only in some jurisdictions) or a termination regime. The default regime generally involves government giving notice of the occurrence of a certain default (for example, a serious service failure, fraudulent behaviour by the private party or the private party's right to draw down funds being materially restricted) and the private party using a cure period to rectify;
- **termination events.** Government may be able to terminate the contract should certain termination events occur. These might include: the private party abandoning the works, default events not being cured, breaching the change of ownership/control provisions or an insolvency event in relation to the private party. The private party may be entitled to compensation after termination;
- **termination payments.** The private sector will be entitled to a termination payment subject to a range of specific principles used to calculate this value;
- **government step-in.** Government may be able to step-in and assume all or some of the service delivery obligations of the private party in certain circumstances including when:
  - there is an emergency, a serious risk to the environment, the public or users of the facility or a serious risk of material damage to public or private property; or
  - step-in is necessary to discharge a statutory duty.

- **end of term arrangements.** The private party is often required to ensure that the project assets meet the government's return conditions at contract expiry. To ensure this contractual obligation is met, an independent assessor is usually appointed to inspect the facilities. The assessor may then notify government and the private party of the works to be carried out, a reasonable program and the expected cost of carrying out the works.

Specific examples of key commercial principles applicable to economic infrastructure include:

- **force majeure.** In economic infrastructure projects, the private party often bears a higher level of risk in relation to force majeure damage. In broad terms, it only has limited relief from its obligation to make available the infrastructure and provide related services. The private party generally does not have, for example, any right to terminate the project in the event that the effects of the force majeure are long-lasting and if it has no right to receive a termination payment from government;
- **compensation events.** There are generally fewer circumstances in which government is prepared to compensate the private party on a value for money basis in the case of an economic infrastructure project than is the case of social infrastructure. This is because the private party in social infrastructure projects is dependent on the service fee from government as its sole source of revenue. It has no ability to grow its market, increase prices or source other streams of revenue;
- **default termination payments.** The private party is generally not guaranteed any payment by government if the concession is terminated as a result of default by the private party. This is in contrast to the termination payment regime for social infrastructure projects; and
- **default, cure rights and termination for default.** The private party will typically have the benefit of more generous and/or flexible rights (such as extended or rolling cure periods) for the private party and its financiers to cure or rectify events of default before government will have a right to terminate the project agreement for default. This is due to the lack of default termination payments provided to the private party in an economic infrastructure project.

## 6 Value for money

### 6.1 Value for money

Value for money is a critical focus of PPP procurement. The value for money assessment allows procuring agencies to establish whether service delivery has been structured to appropriately meet the service output while continuing to ensure reasonable stewardship of financial resources.

The assessment of value for money should encompass all aspects of the proposal including both quantitative and qualitative elements.

#### 6.1.1 The PSC and quantitative assessment

The PSC is the financial benchmark in the quantitative assessment of value for money during the tender process and the evaluation and comparison of RFP responses. The RFP responses will be assessed against the PSC to determine whether they offer value for money in respect of quantitative analysis.

RFP responses will be ranked according to their risk-adjusted Net Present Cost ("**NPC**") relative to each other and to the risk-adjusted PSC. Adjustments may be made to the NPC of individual RFP responses according to their preferred risk allocation.

As considered in the *Commercial Principles for Social Infrastructure*, all risks to the extent not explicitly taken by government will be borne by the private party. The financial impact of the risks taken by government (e.g. retained risk) should be added to each RFP response to show the total project delivery cost.

#### 6.1.2 Qualitative and broader value for money considerations

A complete value for money assessment requires consideration of qualitative factors along with the quantitative assessment (including the infrastructure and services solution). Identifying the best outcome requires a flexible valuation process and the consideration of the qualitative factors associated with the RFP responses that have not been explicitly valued.

Examples of qualitative factors that may be considered include:

- service delivery and operational requirements;
- interface/relationship and project management; and
- a range of design considerations.

## 6.2 Definition and purpose of the PSC

The PSC is an estimate of the hypothetical, risk-adjusted whole-of-life cost of a public sector project if delivered by government. The PSC is priced on a reference project that is designed on a desired output specification and incorporates adjustments for transferred and retained risks. The reference project will be defined and costed on the desired output specification, matching the quality of service that will be expected from the private sector. The reference project is not an in-house bid.

The reference project should:

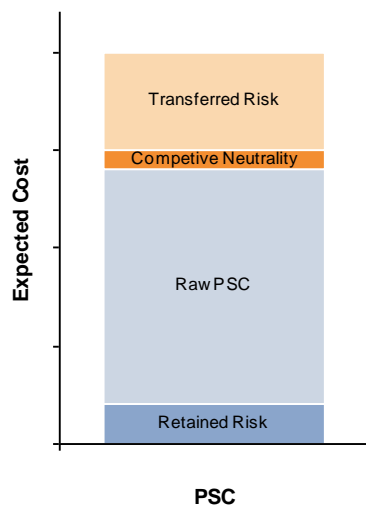
- reflect the most likely and achievable procurement approach by the procuring agency to satisfy *all* elements of the output specification if the project were to proceed on a traditional basis; and
- provide the same level and quality of service as expected to be provided by the private party to enable a like-with-like comparison.

The purpose of the PSC is to provide government with a benchmark to assess the value for money (in quantitative terms) it can expect from accepting a private sector proposal to deliver the output specification compared with public sector delivery.

The PSC represents the net present value of the total whole-of-life cost to government of meeting the output specification under direct public procurement. It consists of the following components (which are also represented in *Figure 4*):

- retained risk;
- the raw PSC;
- a competitive neutrality adjustment; and
- transferred risk.

**Figure 4: Components of a Public Sector Comparator**



A PSC should be developed for all PPP projects to assist in the assessment of whether private sector delivery offers better value for money than traditional procurement. In the rare situations where government may agree that a PSC is not required, an appropriate benchmark still needs to be constructed to demonstrate value for money. Further detail on the use of the PSC is contained in *Public Sector Comparator Guidance*.



## 6.3 The procurement process and the PSC

### 6.3.1 Disclosure of the PSC

The government's position on the disclosure of PSC information should be detailed in the RFP. Generally, the raw PSC will be disclosed unless there are justifiable (commercial) reasons for non-disclosure. As part of this, the key assumptions (financial and operating) should be disclosed. However, the timing of disclosure will be determined by individual jurisdictions on a case-by-case basis. The disclosure of the total PSC value, e.g. the risk-adjusted PSC (either in periodic cash flow or NPC form) will be disclosed in circumstances where this is deemed appropriate.

### 6.3.2 Refining the PSC during the RFP Phase

The PSC should be finalised as part of the development of the RFP documentation and before RFP release.

In general, the PSC should be refined only after release of the RFP if the scope of the project changes or it becomes apparent that a significant component has been mispriced or omitted. If a RFP response demonstrates a more efficient delivery method than that identified by the project team in constructing the PSC, the PSC should *not* be changed to reflect the alternative delivery method.

Government approval is often required for any major amendments to the approved PSC after the RFP process begins.

## 7 Conclusion

The Guidelines represent a national framework that applies across all States, Territories and the Commonwealth.

The *Overview* and *Detailed Guidance Material* represent current best practice in the delivery of PPP projects and will promote consistency in the application of the PPP process and risk allocation thereby creating efficiencies in the tender process for both public and private sector participants.

The agreed *National PPP Policy Framework*, which outlines a national approach to determining PPPs, will also improve consistency in the consideration of PPPs as a procurement method.

The Guidelines are the agreed position of all jurisdictions and represent a fair balance between public and private sector interests. The Guidelines are detailed enough to be useful for practitioners and are flexible enough to accommodate the specifics of individual projects or jurisdictional requirements.

This Overview document should be read in conjunction with the *Detailed Guidance Material* and *National PPP Policy Framework*.

The next step for practitioners is to:

- refer to the *National PPP Policy Framework* to confirm the application of PPP policy; and
- read the *Detailed Guidance Material* on PPP project delivery, the *Public Sector Comparator Guidance* and other guidance on commercial principles.

## Appendix A: Glossary

Term	Meaning
BAFO	Best and final offer; as part of the RFP phase, this is a further short listing process to determine a preferred bidder
BOOT	Build, own, operate and transfer
Business Case	The document that articulates the rationale for undertaking an investment
Competitive neutrality	The competitive advantages that accrue to a government business by virtue of its public sector ownership
Conflict of interest (COI)	Arises where a member of a project team, or an adviser to a project team has an affiliation or interest which might be seen to prejudice their impartiality
Consortium	Those private party persons who together intend to deliver a PPP
Consortium members	Those persons who, together with other persons, make up a consortium
Contract summary	The document that is released to the public following financial close that sets out the key aspects of the project, including contract terms
Core Services	For social infrastructure, this refers to those services for which governments have particular responsibilities to people using the service and the community (e.g. hospitals, schools, etc.). Services included in this definition will be determined on a case-by-case basis
D&C	Design and construct
DBFM	Design, build, finance and maintain
DBFO	Design, build, finance, operate
DBOM	Design, build, operation, maintain
DCM	Design, construct and maintain
Discount rate	The rate used to calculate the present value of future cash flows, usually determined on the basis of the cost of capital used to fund the investment from which the cash flow is expected
EOI	Means expressions of interest for a project
EOI phase	The phase used to shortlist parties to proceed to the RFP phase who are capable of delivering the project
EOI respondents	The parties submitting a response to an Invitation for EOI issued by government for a project

Term	Meaning
EOI responses	The responses from the market to the Invitation for EOI issued by government for a project
ESD	Ecologically sustainable development
Guidelines	These National PPP Guidelines
Intellectual property (IP)	Inventions, original designs and practical applications of good ideas protected by statute law through copyright, patents, registered designs, circuit layout rights and trademarks; also trade secrets, proprietary know-how and other confidential information protected against unlawful disclosure by common law and through additional contractual obligations such as confidentiality agreements
Interactive tender process	The process of interaction between shortlisted bidders and key stakeholders during the RFP phase as outlined in the <i>Practitioners' Guide</i>
Invitation for EOI	An invitation to the market to seek expressions of interest for a project
Jurisdictional requirements document	The set of specific guidance applicable to individual jurisdictions that are to be read in conjunction with the Guidelines
National Commercial Principles for Social Infrastructure	Those principles of the Guidelines that set out the considered position of government across jurisdictions in relation to risk allocations under a PPP. This is set out in <i>National Commercial Principles for Social Infrastructure</i> .
National PPP Guidelines	The suite of guidance material that will form the national guidance on PPPs
National PPP Policy Framework	The document that will detail the scope and application of the National PPP Guidelines across governments in all jurisdictions
Negotiation and completion phase	The phase involving negotiations with the preferred bidder and finalisation and completion of contractual agreements
NPC	Net present cost
Output specification	The document that defines the outputs and performance levels in relation to construction and services for the project and incorporates those aspects as identified in the <i>Practitioners' Guide</i>
PPP	A public private partnership
Preferred bidder	A shortlisted bidder selected following the RFP 'Evaluation' phase as preferred and to proceed to the negotiation and competition phase
Probity practitioner	An independent expert retained to monitor the bidding process at critical stages, assessing and reporting whether the process has been conducted to the required standards of probity
Procurement options analysis or strategy	The document that outlines the rationale for adopting various procurement methods for a particular project

Term	Meaning
Procuring agency	The government body (department, agency, statutory body or GBE) that is responsible for delivering the project on behalf of government
Project director	The person with overall responsibility for delivery of the project and management of all members of the project team
Project steering committee	The committee of departmental/agency representatives established by the procuring agency to direct the development of the PPP project and deal with key issues
Project team	The group of specialists and departmental/agency representatives, established by the procuring agency, that is responsible for assisting the project director to deliver the project (including developing project documentation and undertaking evaluation processes)
PSC	The public sector comparator for a project, which is defined in the Guidelines as the hypothetical, risk-adjusted whole-of-life cost of a public sector project if delivered by government
Raw PSC	The base cost to government of producing and delivering the reference project (with no adjustment for risk)
Reference project	The basis for calculating the PSC, reflecting government delivery of the project by traditional means
Relevant PPP authority	The government department or agency responsible for the application of PPP policy within a jurisdiction (often Treasuries)
Retained risk	The value of those risks or parts of a risk that government bears under a PPP project
RFP	A request for proposal issued by government for a project
RFP 'bid' phase	The part of the RFP phase where shortlisted bidders are preparing RFP responses
RFP 'development' phase	The part of the RFP phase where government is preparing RFP documentation for release to shortlisted bidders
RFP 'evaluation' phase	The part of the RFP phase where government is evaluating RFP responses
RFP phase	The phase involving the release of the RFP to shortlisted bidders for detailed, fully costed and binding RFP responses, followed by evaluation and selection of the preferred bidder
RFP response	A proposal from a shortlisted bidder in response to the RFP issued by government for a project
Risk allocation	The allocation of responsibility for dealing with the consequences of each risk to one of the parties to the contract; or alternatively, agreeing to deal with a particular risk through a specified mechanism which may involve sharing that risk

Term	Meaning
Shortlisted bidder	Those parties invited to submit a proposal in response to an RFP issued by government for a project
Special purpose vehicle (SPV)	In establishing a project consortium, the sponsor or sponsors typically establish the private party in the form of a special purpose vehicle (SPV) which contracts with government. The SPV is an entity created to act as the legal manifestation of a project consortium
Tender process	Includes each of the following phases: <ul style="list-style-type: none"> <li>➤ EOI phase;</li> <li>➤ RFP phase; and</li> <li>➤ negotiation and completion phase</li> </ul>
Traditional procurement	The delivery of the infrastructure and associated services by government using a design and construct procurement processes
Transferred risk	The value of those risks (from government's perspective) that are likely to be allocated to the private party under a PPP project
Whole-of-life	The integration of up-front design and construction with ongoing maintenance and refurbishment elements over the life of the asset under the PPP arrangement