

# The Environment for Public-Private Partnerships in New Zealand

A Discussion Paper Prepared for the  
New Zealand Council For Infrastructure Development



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# 1. Executive Summary

Public agencies are facing increasing difficulties in meeting the infrastructure demands of their communities. Internationally, the public sector is increasingly turning to the private sector for assistance in dealing with this infrastructure funding gap as, under the right conditions Public-Private Partnerships can and do deliver better value for money than traditional public sector delivery models. For example:<sup>1</sup>

- The National Audit Office in the United Kingdom examined a number of privately financed projects and concluded that seven of the projects provided a saving of £900 million with the total value of the projects being £3.6 billion.
- The UK Treasury Task Force examined a sample of 29 projects and concluded that they provided an average cost saving of 17% over public sector delivery.

The main challenge facing Governments is to create the ‘right environment’ to enable the potential of PPPs to be fully realised whilst meeting the public sector’s objectives. New Zealand has opened the door for limited road tolling and private sector involvement in roading with the introduction of the Land Transport Management Act.

Used appropriately there is clearly scope for New Zealand to benefit from PPPs. As yet, however, there are no roading PPPs being progressed in New Zealand under the new Act. Instead Transit New Zealand has adopted a public sector tolling model with the public sector retaining all operational responsibilities for toll schemes and also retaining all of the project risks. Transit appears to justify this approach on the grounds that the current policy environment requires a flexible approach to project delivery in order to minimise cost and delays and that a concession agreement under the Act would limit flexibility.<sup>2</sup> Transit’s approach was formally confirmed with the recent Ministerial decision to grant approval for ALPURT B2 (the extension of the Northern Motorway) to proceed as a road toll scheme with Transit being the road controlling authority, the toll operator, and the enforcement agency.

Transit’s approach suggests that the uncertainties and risks created by the current policy environment, including the concession provisions in the Act, are precluding the advancement of PPPs for roading. The conclusions reached in this paper confirm such a view. The Act sets in place a number of constraints on the effectiveness of private sector participation in new roading schemes. While a number of these are manageable, there are at least three significant constraints, the culmination of which provides a significant disincentive to private sector involvement in roading projects.

The three key constraints of the Act to private sector involvement are as follows.

- (a) The inability to toll existing infrastructure. This is a particular problem given that our strategic roading network has been constructed on a piecemeal basis as and when funding and regulatory approvals became available. This means that there are very few opportunities to develop a new piece of contiguous infrastructure. Instead, it is often linking into another piece that was built several years (or decades) ago (SH20 which has been constructed a few kilometers at a time is a good example). Arguably, the whole strategic route should be operated and tolled as a whole. This will not only reduce the need for public subsidies to be provided to toll schemes but will also ensure better consistency of operation and demand management.

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<sup>1</sup> Private Financing of Public Assets: Practical and Policy Problems (2004), Robert Lonegran

<sup>2</sup> The case for ALPURT B2 as a Toll Road, (2004), Transit New Zealand.

(b) The requirement that a “concession agreement must not include any provision that provides a disincentive for a person to pursue other sustainable transport options (for example, public transport or the implementation of demand management strategies)” (section 56(6)). The purpose of a using PPP is to provide a new piece of roading infrastructure in the way that provides best value for money to the public sector. Correspondingly, the private sector must be satisfied that, after taking into account all of the risks that it must bear, it can make a profit. In other words, both parties need it to be a “success” in terms of meeting their respective objectives. This section however, could see the following types of provisions interpreted as a disincentive:

- Compensation provisions if traffic volumes fall below a certain level.
- Assurances regarding the introduction of competing routes and modes.

This provision requires the private sector to assume a substantial amount of risk for elements that remain within the public sector’s control. It also provides a mixed message: we want your money to develop roading infrastructure that we can’t afford, but we want the ability to be able to seek to reduce roading demand.

(c) The third key constraint in the Act relates to the Ministerial consenting and approval processes. This is perhaps the biggest disincentive to private sector involvement. The consenting/approval process by which a concession agreement for a toll scheme can be granted is quite simply too hard, too expensive and too uncertain to be seen as genuinely encouraging private sector involvement.

The United Kingdom and Australia (through the States of Victoria and NSW) have developed comprehensive policy frameworks to evaluate the value for money of a PPP when compared to the public sector alternative. In both countries, it is necessary to assess a PPP option whenever new infrastructure is being planned, but the PPP option is only adopted where it clearly provides best value for money.<sup>3</sup>

A key recommendation of this paper is that to effectively utilise PPPs it would seem sensible for New Zealand to follow the examples set by Australia and the United Kingdom. This would involve developing a comprehensive assessment framework to determine the benefits that arise from a PPP approach as compared to public provision. Providing one Government agency with a leadership role, as occurred in the UK and Australia could well assist this process.

Overall, the current legislative framework appears to put in place significant disincentives to the development of PPPs. As a result the prospect of a successful PPP being implemented under the current legislation is unlikely. The only real solution is legislative change to address the constraints inherent in the LTMA. This is unfortunate because there are significant opportunities to consider using PPPs to deliver roading projects in New Zealand.

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<sup>3</sup> Counsel: The “best value” approach to PPP and public contracting (2004), Chapman Tripp.

## Key Messages

Under the right conditions Public-Private Partnerships can and do deliver better value for money than traditional public sector roading delivery models. Used appropriately there is scope for New Zealand to benefit from PPPs in delivery of roading infrastructure.

Although New Zealand has opened the door to road tolling and PPPs, there are no roading PPPs being progressed under the new Act. Transit New Zealand has adopted a public sector tolling model with the public sector retaining all operational responsibilities for toll schemes and also retaining all of the project risks.

The uncertainties and risks created by the PPP provisions in the new Act (the Land Transport Management Act) make it unlikely that PPPs for roading will be successful. The Act sets in place a number of constraints, as well as extensive consultation and approval processes, the culmination of which provides a significant disincentive to private sector involvement in roading projects. Legislative change is needed if PPPs are to be viable in New Zealand.

The UK and Australia, which are at the leading edge of PPP developments, have both developed comprehensive policy frameworks to evaluate the value for money of a PPP when compared to the public sector alternative. At the moment, New Zealand roading agencies are operating in a policy vacuum. As well as legislative change, if New Zealand is to effectively utilise PPPs, then it is necessary to develop a comprehensive policy and assessment framework for determining which projects should be developed under PPP and public sector models.

## 2. Introduction

Public sector agencies worldwide are facing increasing difficulties in meeting the infrastructure demands of their communities. Driven by population growth, economic growth and rising community expectations, the backlog of publicly provided infrastructure continues to grow. In addition, whilst the scale of this infrastructure backlog varies across countries, the problem extends across poor and wealthy nations alike.

Internationally, the public sector is increasingly turning to the private sector for assistance in dealing with this infrastructure funding gap. There is growing acceptance amongst many nations that the private sector can, and should play a larger role in helping to finance, develop and operate new infrastructure, in partnership with the public sector.<sup>4</sup>

New Zealand is one of many countries facing its own infrastructure backlog. A recent press release from the NZCID identified one of the major infrastructure problems facing New Zealand:

“Motorists looking at Transit New Zealand’s 10 year state highway forecast could be excused for wondering what’s happened to the extra 10 cents fuel tax they were promised would fix the roads. A comparison of this years plan with the 2004 plan shows that many of the high profile state highway projects won’t be completed any sooner, despite the increased fuel tax, and almost all of the critical congestion and safety projects across the regions are still years from completion.”

New Zealand has opened the door for private sector involvement in roading with the introduction of the Land Transport Management Act. The Act allows the tolling of new roads and concession agreements with the private sector under certain circumstances.

Now, with the new legislation bedded in, pressure increasing on already congested roads and the costs of delaying major projects mounting, it is an appropriate time to reflect on New Zealand’s experience so far under the new legislation. It is the right time to ask whether the new Act is being utilised to the full extent possible and what, if any changes are needed to unlock the potential which lies within?

The paper undertakes this by firstly looking at the theoretical justification for considering a public-private partnership rather than relying solely on a public sector delivery model and then looking at what key lessons might be learned from international examples of Public-Private Partnerships. The next section looks specifically at the New Zealand situation with a critique of progress to date on three key projects, ALPURT B2, the Tauranga Harbour Link and the Toll Systems Project (TSP). The critique considers the delivery models employed for these projects and asks whether opportunities for private sector involvement have been missed. The paper then considers the opportunities within the LTMA framework, where this framework might be overly restrictive, and amendments that could assist to unlock the potential of private sector delivery options. The paper concludes with a series of recommendations in terms of both actions and approaches that can be taken now under the current legislative framework and options for statutory reform. It is hoped that this paper will assist to promote further thought and discussion around the current environment for PPPs in New Zealand.

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<sup>4</sup> Fitch Ratings (2003), Public-Private Partnerships: The Next Generation of Infrastructure Finance

### 3. If a PPP is the answer, what was the question?

#### Defining the Term “Public Private Partnership”

Because the term Public-Private Partnerships is so widely used, it is important to begin by defining what is meant by the term within this paper. Broadly speaking, a public-private partnership can encompass any relationship between the public and private sectors which produces an asset or delivers a service. Public-Private Partnerships exist in a wide variety of forms and applications and are the standard way of delivering many public sector outputs in New Zealand. Road design, construction and maintenance are examples. The focus of this paper is on the types of public-private partnerships designed to facilitate the transfer of a broad spectrum of project risks from the public to private sector in exchange for the private sector providing project finance and earning a return on investment which reflects the cost of the risks transferred. Partnerships of this nature can be described as private finance initiatives (PFIs)

There are a large number of international examples of public-private partnerships in the roading sector which involve transferring responsibility for undertaking not just design, construction and maintenance of roading, but also financing and operational responsibility to the private sector, for a defined period of time. Representative types of project delivery structures utilised in public-private partnerships for roading projects include BOOT (Build, Own, Operate, Transfer), BOT (Build, Operate, Transfer), DBFM (Design, Build, Fund, Manage), DBFO (Design, Build, Finance, Operate). These models of public-private partnerships are characterised by a high degree of sharing of investment, risk, responsibility and reward between public and private partners. Critically, they allow for greater opportunity for the public sector to transfer specific project risks to the private sector than would be the case under a simple design and construct model.

#### 3.2 Why consider using a PPP?

It is the responsibility of the public sector to ensure that it is acting in the best interests of its community. The only sound policy rationale for utilising a PPP is to gain better a better outcome for the community than would be the case under traditional public sector procurement. Where a PPP offers greater value for money than the public sector alternative whilst meeting the broader objectives of the public sector then it is obviously in the public interest to adopt this approach. Conversely, it is equally obvious that if there is no scope to match the value for money offered by public sector provision then the community will be better off if the project is procured through the public sector.

Of course, it is easy to say this. It may be much more difficult in practice to identify exactly what constitutes value for money and this is dealt with in more detail in the next section. What can be said here is that decisions on project delivery structure driven by ideology, whether in favour of public or private provision, do not tend to guarantee value for money. A recurring criticism of the early UK approach was that PPPs were often presented as being the “only game in town” leading to sub-optimal outcomes in a number of cases. Conversely, overlooking opportunities for project delivery through a PPP will also fail to ensure that value for money is achieved as, under the right conditions, PPPs for infrastructure projects such as roading have been demonstrated to deliver better value for money to the community. For example:<sup>5</sup>

- The National Audit Office in the United Kingdom examined a number of privately financed projects and concluded that seven of the projects provided a saving of £900

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<sup>5</sup> Private Financing of Public Assets: Practical and Policy Problems (2004), Robert Lonegran

million with the total value of the projects being £3.6 billion.

- The UK Treasury Task Force examined a sample of 29 projects and concluded that they provided an average cost saving of 17% over public sector delivery.

### 3.2.1 The Advantages of PPPs

The ways in which PPPs can deliver better value for money than public sector procurement occur through a number of mechanisms that are intrinsic to this method. These mechanisms include:

- **More Efficient Risk Allocation**

A key element of the PPP approach is the potential to more efficiently allocate project risks by transferring certain project risks to the private sector. Efficient allocation of project risks, based on an understanding of the parties' abilities and incentives to manage risk, is a critical area where improved value for money can be achieved through a PPP. Optimal risk allocation recognises that certain risks are managed more cost effectively by the public sector while others are better handled by the private sector.

Opportunity for efficient risk allocation is dependant to a large extent on the type of project delivery option chosen. The more control that is passed to the private sector, the greater the opportunity to pass risks. However, the private sector may be unlikely to accept certain risks where the extent of the private sector's ability to control this type of risk is extremely limited. Generally speaking, the private sector tends to take a more robust approach towards identifying and pricing risks than the public sector.

An understanding of the respective parties' abilities and incentives to manage risk enables the true cost of the public sector retaining or transferring project risks to more accurately estimated. Failing to understand the true cost of project risks can be expensive. A New Zealand example of the real cost associated with the public sector retaining key project risks in exchange for an apparently lower cost of finance is Tauranga's Route K. Tauranga City Council debt financed the project with debt repayment being funded from toll revenues. Debt financing provided an apparent advantage in that it attracted a lower rate of interest than a finance package consisting of private sector debt and equity with the financiers accepting the risk of project revenues not reaching predicted levels. In this case, actual project revenue has not matched projected revenue and the shortfall has to be met by ratepayers. This illustrates the potential value of a higher cost of finance in exchange for the mitigation of a key project risk to the public sector.

- **Innovation and Competition**

Taking an output focus enables the private sector to be innovative in their approaches to infrastructure design, building, operation and maintenance. Competition can also drive innovation from the private sector which can generate cost savings and improvements in infrastructure that support public sector service delivery. The result is that the opportunity for more cost efficient provision of a project or parts of a project can combine with the opportunity for higher quality provision of a project/parts of project. Given the enormous cost pressures now evident in the roading sector there is clearly an imperative to consider what opportunities this might offer for New Zealand.

- **Whole-of-Life Management**

Integration and synergy between the design, building and service operations and maintenance can realise additional savings. Value is added through innovation and project synergies where the specification of outputs rather than inputs promotes innovation. At the same time the potential to secure operating cost savings from PPPs is widely accepted.

### 3.2.2 Disadvantages of PPPs

Offsetting the potential advantages of a PPP are a number of factors which need to be carefully considered:

- **Time and Cost**

High transaction costs arising from complex processes and the need for highly skilled resources to develop, manage and monitor projects are a common factor across large PPPs, at least during initial projects. A recurring theme which all parties involved in PPPs agree upon is that to get the best outcomes from a potential PPP the public sector must be adequately resourced, both in terms of financial capability and human resources at the project development, evaluation and tendering stages. Under-resourcing at this stage will expose the public sector to the risk of losing the potential benefits which a PPP might deliver, (eg. through choosing a suboptimal procurement strategy, or failing to successfully transfer risks associated with benefits).

Implementing a PPP procurement process in the New Zealand context will probably add to the time required for project development due to the need to undertake a rigorous comparison between alternative procurement methods when, at present, no standard policy framework exists for this purpose. This assessment must be undertaken in sufficient detail to provide confidence that the recommended procurement strategy will deliver the best value for money. It must also be recognised that if a PPP approach is adopted, the tendering, bid evaluation and negotiation process will be complex and highly detailed.

Set against this, experience has shown that once a contract is successfully let a PPP will provide incentives for early project delivery as this reduces the holding costs and hence increases the revenue earning potential of the project for the concessionaire.

- **Inflexible contracts**

The risk of being locked into an inflexible long-term contractual arrangement with only one opportunity to negotiate is often cited as an issue with PPPs. Linked to this is a risk of compromising future network developments where a roading PPP is being considered. In practice this risk is not generic but a matter to be dealt with through negotiation.

- **Potential Trade-off between Financial and Social Objectives**

To be viable, a PPP scheme must be financially attractive to the private sector. Generally this means that non-revenue generating elements of the project will remain the responsibility of the public sector, at least from a funding perspective. This has had a tendency in some examples to focus project development around the financial optimisation of a project, which might come at the expense of broader social/public good outcomes. A way of managing this is to identify early the public good outcomes required by the project proponent and the funding available to procure these outcomes and to integrate this requirement into the project's development at an early stage.

### 3.3 The Need for a Standard Policy Framework for Objectively Assessing Value for Money

The issues which any investigation of the potential benefits of a PPP as compared to traditional public sector procurement must address are:

- Will a PPP deliver the objectives sought from the project by the public sector?
- Will procurement through a PPP approach deliver better value for money than traditional public sector procurement?

The United Kingdom and Australia (through the States of Victoria and NSW) have developed comprehensive policy frameworks to evaluate the potential to achieve better value money through using a PPP as compared to the public sector delivering a project itself. In both countries it is necessary to assess a PPP option whenever new infrastructure is being planned, but the PPP option is only adopted where it clearly provides best value for money.<sup>6</sup> Importantly, both countries are much closer to asking: why should the public sector build, own and maintain a particular project, than is the case in New Zealand at present.

In both countries, the key tool used to provide a consistent approach to identifying value for money from PPPs is the Public Sector Comparator. The Public Sector Comparator establishes a quantitative benchmark against which the value for money delivered by private bids is compared. Given the pivotal role of the Public Sector Comparator it is important that it is transparent, independent, fair and accurately reflects the whole of Government's costs and benefits.<sup>7</sup> Critically, to provide a valid comparison the Public Sector Comparator must reflect the additional risk that cost overruns and delays may arise for the public sector that under a PPP will fall to the private sector.<sup>8</sup>

However, recent developments in the UK point to the need for the assessment of project delivery options to include a broad range of benefits and not solely relying on a financial assessment of a project's ability to generate cost savings.<sup>9</sup> This will ensure not only value for money but also that the public sector's broader policy aims are met by projects.

Therefore, a key recommendation of this paper is that to effectively utilise PPPs New Zealand must follow the examples set by Australia and the United Kingdom. This would involve developing a comprehensive assessment framework to determine the benefits that arise from a PPP approach as compared to public provision. Providing one Government Agency with a leadership role, as occurred in the UK and Australia could well assist this process.

## 4. International Experience

Various forms of PPP are responsible for the creation of significant amounts public sector infrastructure, including roads in Europe, South America, Australia and parts of Asia. For example, in New South Wales, a large number of public infrastructure projects have been financed in whole or in part by the private sector. This includes all of the private toll roads in the Sydney metropolitan area (the M2, M4, M5, M7 and the Eastern Distributor). Also provided have been the New Southern Railway, the Port Macquarie Base Hospital, the Olympic Stadium, the Olympic Athlete's Village and Sydney Light Rail.

European examples of roading PPPs have been covered in a recent paper by Robert Lonergan.<sup>10</sup> The paper found that a notable feature of European roading PPPs was the diversity of payment mechanism, from real tolls (Germany, Ireland) to payment mechanisms which incentivise the private sector to achieve specified outcomes (United Kingdom, Norway). Interestingly, the payment mechanism seemed to have little influence on the risk premium of particular projects. The experience of Ireland and Germany shows that certain types of road can be successfully funded via real tolls but frequently the public sector will be required to contribute more than 50% of the project's capital cost.

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<sup>6</sup> Counsel: The "best value" approach to PPP and public contracting (2004), Chapman Tripp.

<sup>7</sup> ABN AMRO Australia Limited's Response to the NSW Government's Green Paper (2001), ABN AMRO.

<sup>8</sup> Private Financing of Public Assets: Practical and Policy Problems (2004), Robert Lonergan

<sup>9</sup> The Middlesex Hospital PFI (2002), National Audit Office

<sup>10</sup> Private Investment in Public Roads: Policy and Practical Problems (2005), Robert Lonergan

Australia is at the leading edge of roading PPPs funded through real tolls. The Australian project delivery model has evolved considerably since the PPP project, the Sydney Harbour Tunnel, in 1987. This project was financed without any private equity and the Government underwrote the minimum traffic flow.<sup>11</sup> The following M4 (1988) and M5 (1990) projects were financed largely by debt with only small equity contributions from contractors but all of the construction, operating, traffic and revenue risk was transferred to the private sector parties.

The M2 motorway (1994) was the first project to feature publicly listed equity and a CPI linked bond issue. The project was also the first to involve full risk transfer to the private sector. This set in place the model for subsequent projects including the Eastern Distributor and Melbourne's City Link, M7 and the Mitcham to Frankston Freeway. A feature of these projects was the increasing role of project equity and the use of innovative funding tools, in conjunction with a reduction in the pricing of project risks as the model has matured.

Another feature of the Australian experience is that the proportion of private sector funding in toll schemes is relatively high. The M4 motorway was constructed with no financial support from the Government, except providing the developers with a long-term lease of the land required for the road.<sup>12</sup>

The market for roading PPPs in Australia is now relatively mature. The private sector has gained significant experience of the risks associated with toll schemes, particularly traffic volumes. This experience has led to the private sector being able to price risks more competitively and increase the amount of capital it is prepared to invest in particular projects. Sydney's M7 motorway, which will cost around A\$1.5 billion is being constructed with a Government contribution of only A\$356m. It would seem sensible for New Zealand to capitalise on Australia's experience and market maturity. A way of achieving this would be to adopt a policy framework which is consistent with the Australian model.

## 5. Progress under the LTMA – A Review of Major Projects

The Land Transport Management Act provides New Zealand with generic legislation allowing for the development of tolling schemes and concession agreements for the delivery and operation of new roading infrastructure under certain circumstances. This section reviews the progress to date on advancing projects under these sections of the Act and looks in particular at the public tolling delivery model which Transit New Zealand has adopted.

Currently two roading projects (ALPURT B2 and Tauranga Harbour Link) are being progressed as toll schemes with a number of further projects now being considered for tolling. Transit is also progressing the National Toll Systems Project which is intended to deliver an integrated tolling system for all New Zealand toll roads.

### 5.1 ALPURT B2

#### Project Outline

The 7.5 kilometre State Highway 1 Northern Motorway extension (ALPURT B2) from Orewa to Puhoi is the first state highway project to be brought forward by tolling.

The existing SH1 route from Orewa to Puhoi is a national strategic route that suffers major traffic flow and safety problems. Investigations have shown that there are limited opportunities to improve or

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<sup>11</sup> The Guide to Financing Transport Project 2<sup>nd</sup> Edn (2000), Macquarie Corporate Finance

<sup>12</sup> The Guide to Financing Transport Project 2<sup>nd</sup> Edn (2000), Macquarie Corporate Finance

upgrade the existing route and Transit has consequently considered for some time that a realignment of SH1 is necessary to:

- Cater for present and future traffic growth
- Improve the safety of the existing route and reduce the current high accident rate
- Reduce congestion in the Orewa, Silverdale and Hibiscus coast generally.

As ALPURT B2 is not considered a priority for full public funding, Transit developed a process to explore the potential for advancing ALPURT B2 as a toll road, as enabled under the Land Transport Management Act 2003 (LTMA). In Transit's view, the LTMA enables Transit to bring forward the completion of ALPURT B2 by funding part of its construction through debt finance. Tolls will be used to repay this debt. Although this is true, Transit's consultation does not acknowledge the opportunity to employ private sector debt and equity to assist in advancing projects.

Transit assessed that ALPURT B2 meets Transit's Toll Road advancement criteria under the policy paper Alternative Methods of Funding Future Highway Projects. This states that projects can be advanced to their earliest possible start date if revenues from tolls or other sources cover the debt servicing costs incurred through borrowing to advance a project. Based on a worst-case scenario of costs and low case traffic volumes, it was found that the costs of advancing the project start date by 10 years could be covered by toll revenues over a tolling period of approximately 30-35 years.

On 11 April 2005 an Order in Council was granted by the Governor-General allowing tolling on ALPURT B2. It should be noted that the Order contains a large number of conditions, including the investigation of alternative tolling approaches.

### **Project Delivery Model**

After evaluating options for delivery, including a concession agreement, Transit chose a public sector tolling delivery model for ALPURT B2. Key factors influencing this choice, according to Transit<sup>13</sup> were:

- Flexibility to adopt to changes in the policy environment
- The need to deliver the project on a fast track basis
- The ability to benefit from experience in toll systems development and implementation
- The need for flexibility in the scope of the work, including environmental and social aspects
- Efficiency of risk allocation and limited experience with toll roads in New Zealand
- External factors, including flexibility to adapt tolls to match any general pricing framework developed for the Auckland Region

A highly important matter which the consultation documents for ALPURT did not elaborate on in any detail was how the chosen delivery structure promoted better value for money than a PPP alternative. Without this analysis it is hard to conclude that Transit have indeed chosen the best approach. The public sector project delivery structure being used by Transit involves public sector ownership and management of a toll scheme with revenue risk being retained by the public sector.

A major concern with this delivery model is that revenue risk is retained by the public sector and underwritten by Land Transport New Zealand who have no control over the operational management of the project. In effect, the agency underwriting the risk has no control over managing this risk. This is completely contrary to the approach expected in a successful toll scheme.

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<sup>13</sup> The case for ALPURT B2 as a Toll Road , (2004), Transit New Zealand.

## Procurement Option

An interesting feature of ALPURT B2 is that Transit has established the Northern Gateway Alliance, comprising Transit, Fulton Hogan, Leighton Contractors, URS New Zealand, Tonkin & Taylor and Boffa Miskell. Transit consider that a project alliance has many advantages over traditional contractual arrangements, where the lowest cost is sometimes given undue emphasis ahead of other priorities.

The Northern Gateway Alliance completed the design development and carried out the consultation required for an Order in Council.

Transit's view is that with an alliance, all of the partners are focused on achieving the project outcomes, such as high road construction standards, timely completion and environmental improvements. Alliance partners are also collectively responsible for delivering the project and share the project risks and rewards. This encourages collaboration, problem-solving and innovation. The alliance working on the Grafton Gully project in Auckland delivered it within Transit's budget and five months early.

## Tolling

In deciding on toll tariffs, Transit concluded that consideration had to be given to the balance between:

- Achieving optimal network utilisation – where a toll is low enough to encourage people to use the toll road, but sufficient to meet the costs of building and operating the toll road; and
- Revenue maximisation – setting the toll at a level that will pay off the toll road sooner, but which could increase the level of traffic diversion. The lower the toll tariff, the longer tolls will need to be charged to repay the debt used to finance ALPURT B2's construction.

Transit chose to set the toll at the level that achieved optimal network utilisation. There would be no preclusion to this approach being adopted within a PPP. What would be required is a compensating subsidy to adjust for lost revenue but that is no different to the situation with public delivery.

A particular issue facing ALPURT are casual users. Given its location, it is expected that ALPURT is likely to be characterised by a large number of casual users. Casual use transactions are likely to cost significantly more to process than an electronic transaction under the Toll Systems Project. Due to the likely elasticity of demand for ALPURT we assume that it will not be possible to pass on the full price of a casual use transaction in order to avoid diverting too much traffic back on to the existing State Highway One. This raises an important question about how the full cost of a casual transaction will be absorbed. It would be extremely concerning if this cost ends up being passed back to Land Transport New Zealand, either via the Toll Systems Project or ALPURT B2, particularly as other toll collection options may be better for a toll road with such a high number of casual users.

## 5.2 Tauranga Harbour Link

### Project Outline

The Tauranga Harbour Link is a four-lane expressway linking central Tauranga and Mt Maunganui. It is a key project within Tauranga's Strategic Roading Network. The project includes the construction of an elevated structure over the Chapel and Marsh Street industrial areas, the duplication of the Tauranga Harbour Bridge and the four-laning of Hewletts Road to Jean Batten Drive. Harbour Link and would bring a range of benefits, including eliminating congestion on the Harbour Bridge and Hewletts Road and improving access to the Port of Tauranga.<sup>14</sup>

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<sup>14</sup> Harbour Link Consultation Briefing Document (2003) Transit New Zealand and Tauranga City Council

## **Project Delivery Model**

The Tauranga City Council and Transit are proposing to bring forward the construction of Harbour Link through a combination of tolling and Land Transport New Zealand funding. To progress the local road aspects of the project, including the bridge, Tauranga City Council would be required to fund 52% of the project. Toll-funding Harbour Link would enable Tauranga City Council to stand by its commitment not to fund the project through rates increases. Even if the entire Harbour Link project were designated a state highway, it would not be included in the State Highway Plan for construction start within 10 years. Transit would only see Harbour Link as a strategic priority if it were constructed as a toll road so that it would enable travel demand management strategies to be implemented.

Tauranga City Council, Transit and Land Transport New Zealand have developed a tolling proposal that includes a contribution of approximately 50% from the National Land Transport Fund (NLTF). The key point is again, that the public sector, through Land Transport New Zealand, is underwriting revenue risk for the project.

## **5.3 Toll Systems Project**

### **Project Outline**

In conjunction with the development of toll schemes Transit is developing a fully electronic and nationally integrated road tolling system, the Toll Systems Project. The objective is to deliver a national interoperable tolling system for application to all toll road projects throughout New Zealand. This is consistent with Transit's desire to be the leader in road tolling in NZ.

Transit argues that it is important to take a coordinated long-term approach to toll collection and processing to ensure consistency of operation. Common technical specifications and operating procedures would apply across any future toll roads. This would allow vehicles to move between one toll road and another, with all transactions and customer data handled through an integrated toll management system. The system would have a single national toll operations centre which would be able to be utilised for all future toll roads in New Zealand, whether or not the roads are managed by Transit.<sup>15</sup>

### **Issues which are relevant to a PPP**

Control of project revenues, through transaction cost control and customer management are critical elements in the success of a toll road. Compelling toll scheme operators to hand control of these two elements to a centralised toll system effectively constrains their ability to manage the main operational risks associated with toll roads. If the Toll Systems Project does require this approach it is likely to make it very difficult and risky for Road Controlling Authorities to commission their own toll projects and would make it very difficult to deliver toll projects through Public-Private Partnerships.

It is not clear from the consultation documents how the Toll Systems Project can deliver the most cost effective tolling solution for New Zealand. The planned charge for ALPURT B2's use of the Toll Systems Project's 'back office' services is approximately 32 cents per transaction. Recent evidence suggests that this may be as high as \$1.35 per transaction, on a toll of \$2.<sup>16</sup> Private sector toll service providers have indicated that they could provide 'back office' services for around 13 cents per

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<sup>15</sup> Toll Systems Project (2004), Transit New Zealand

<sup>16</sup> New Zealand Herald 16/7/05

transaction for an electronic toll system.<sup>17</sup> This raises the serious question of whether the cost and risk associated with the Toll Systems Project is justified when there is potential for a private sector party to provide the same service for considerably lower cost. The potential for private sector toll service provision deserves much greater emphasis than it has received so far.

The timing and scaling of the Toll Systems Project is another major concern. The Toll Systems Project will be built well before the transaction volumes required to make the project cost effective are present, resulting in ongoing losses subsidised by Land Transport New Zealand. This risk is substantial. Given the time and difficulties involved in planning for, consulting on and building toll roads, there is no guarantee that the toll projects and transaction volumes required to make the Toll Systems Project cost effective will eventuate before its technology becomes obsolete.

Transaction volume is therefore a critical risk for the project, yet, it is not accounted for, or even noted as a risk in the Feasibility Study Summary Report. For the Toll Systems Project to operate successfully there is a threshold number of transactions that would be required to make the entire system sustainable and cost efficient. This is likely to be in the region of 80,000 transactions per day.<sup>18</sup> As this threshold is unlikely to be achieved on ALPURT B2 and the Tauranga Harbour Link alone, additional funding for the Toll Systems Project will be required from the National Land Transport Fund in the short to medium term until additional projects come on line.

This raises a further question about the economic efficiency of moving to an electronic tolling system for revenue collection. The Summary Report: Feasibility Study of National Road Toll Collection System Options noted,

“ETC [electronic toll collection] was seen to be more economically efficient... An integrated national back office is comparatively more attractive due to a greater potential to realise the scale economies of system expansion and greater economic efficiency through avoiding duplication of infrastructure and systems.”

But, as noted the comparative economic efficiency of Electronic Toll Collection is dependent upon a number of toll projects. Implicit in this is the fact that at low toll volumes, which is all that can be guaranteed for some time, other forms of collection will be more efficient.

Technology, timing and integration are further issues which need more thought. The Foreword to the Toll Systems Project Consultation document states, “the technology used for collecting and managing toll revenue is constantly evolving”. This makes it important to establish common standards for technological items to ensure interoperability across schemes. This does not create an automatic imperative to establish an integrated national toll system now. In fact, the reverse may be the case.

There is a risk that the ‘back office’ technology installed in 2008 will be suboptimal, if not obsolete, before the next toll projects are completed. This risk could be mitigated by moving to an integrated system with high technology ‘front’ and ‘back’ ends only when there is the transaction volumes to justify such a system. Early commitment for a low volume scheme risks limiting the future potential of the TSP or forcing an expensive system wide upgrade, to accommodate new projects, earlier than may have otherwise been the case.

If central agencies judge that there is a need to provide for interoperability now, then this should take place over a number of phases. The first phase would be agreement by interested Road Controlling Authorities on common specifications for the technical components of toll systems, such as transponders and data transfer protocols, with the option of involvement in an integrated back office

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<sup>17</sup> The New Zealand Environment for Private Road Tolling and Funding (2004), David Cochrane

<sup>18</sup> The New Zealand Environment for Private Road Tolling and Funding (2004), David Cochrane

remaining voluntary. Sydney has successfully moved to a fully interoperable tolling through the use of common standards, rather than an imposed technological solution. Agreement on common specifications would provide opportunities for:

- Access into the market by private tolling companies
- Competition in the provision of tolling services (which would also have the benefit of providing any integrated national toll system with a competitive benchmark)
- Competition for tolling agreements

Later phases could see electronic toll collection systems, with interoperable back offices, being built as toll projects generating sufficient demand are brought on line. This approach would enable New Zealand to gain, over time, the twin benefits of interoperability and competition. It would also avoid the risks and costs to the NLTP associated with committing exclusively to an expensive scheme designed to handle high transaction volumes well before the required volumes are present.

### **Conclusion on the Toll Systems Project**

In summary, it is recommended that any national tolling policy framework or system should:

- allow for transponder interoperability and data sharing between systems;
- provide for competition in the provision of toll systems or their sub-components;
- allow concessionaires to enter the market on an equal basis and not lead to the creation of a monopoly toll provider or give a single organisation monopolistic control over critical data or services;
- be voluntary for Road Controlling Authorities and toll scheme operators;
- be an efficient means of collecting revenue - in that the toll collected provides revenue for the road as well as covering the capital and operating costs of the toll system itself - and does not rely on subsidies from the National Land Transport Fund or other toll projects;
- Be scaled appropriately with more consideration given to adopting an incremental approach to tolling technology. Until it is clear that there will be sufficient certainty on transaction volumes and toll projects to justify an electronic system other less costly options must remain open for consideration.

## **5.4. Conclusions on NZ Projects**

Although the LTMA provides for the use of concession agreements Transit has not adopted this delivery model for the toll roads it is currently proposing. Ironically perhaps, Transit justifies its approach on the grounds that the changing policy environment post the LTMA requires a flexible approach to project delivery which minimises cost and delays should changes be required.<sup>19</sup> Transit concludes that a concession agreement could in fact reduce flexibility, increase costs and add delay to projects. This is an interesting conclusion Transit appears to be implying that the uncertainties created by the concession provisions in the LTMA are precluding the advancement of concession agreements.

Transit is also acknowledging that to implement a successful concession agreement will take a significant amount of time and resources under the current legislative framework. This highlights the need for a different policy approach to encourage PPPs, such as the Partnerships Victoria model.

The major concern with Transit's public sector tolling model is that although it does allow some construction risks to be passed on to the private sector, revenue risk is retained by the public sector. As revenue risk is generally the most significant risk for a toll scheme, the potential implications of this

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<sup>19</sup> The case for ALPURT B2 as a Toll Road , (2004), Transit New Zealand.

approach are significant. In the event of project revenues not meeting expectations, then unless debt repayment can be reprogrammed, a further subsidy from Land Transport New Zealand will be required. The opportunity cost will be that this represents funding which could have gone into other projects. A further issue is that although Land Transport New Zealand are underwriting revenue risk they do not have an operational role in the project, thus they have no control over the revenue stream.

One option which would warrant further investigation is the possibility of public sector toll schemes being transferred to a private sector concessionaire once they have been constructed and begun operation. Although, depending on timing, this might not allow the revenue risk associated with traffic volume ramp up to be passed to the private sector, the cost of finance should reflect the project risk profile.

A further concern is that currently the tolling provisions of the LTMA are only being used to promote projects that are not sufficiently high on LTNZ's priority list to attract public funding. Instead, all projects should be assessed for viability for tolling and for private sector participation. This would ensure that the best toll schemes were developed and would free up public funds for other projects.

Decisions are being made on tolling systems now which will impose future constraints and costs. Transit's intention to develop a national, interoperable tolling system has the hallmarks of a large hammer being used to crack a nut. Until it is clear that there will be sufficient certainty around transaction volumes and toll projects to justify an electronic system thereby avoiding the requirement for subsidy from the National Land Transport Fund, other less costly options must remain open for consideration as part of a more incremental approach. Interoperability, which is an important outcome, can easily be achieved through adopting common technological standards, as is the case in Sydney for example. It is also vital to ensure concessionaires are able to enter the market on an equal basis, rather than having the creation of a monopoly toll provider or giving a single organisation monopolistic control over critical data or services.

## **6. Review of the Land Transport Management Act**

The Land Transport Management Act provides new approaches to structuring and funding project delivery. It also contains a number of constraints. This section will analyse what can be done under the LTMA as well as its constraints. It will also discuss legislative restrictions both in terms of the Land Transport Management Act and more broadly. It will consider what steps should be taken to improve the viability and effectiveness of private sector involvement in roading projects.

### **6.1 What Can Be Done Under the Land Transport Management Act Framework**

The Land Transport Management Act allows for the establishment of a road tolling scheme by Order in Council, on Ministerial recommendation. The purpose is "to provide funds that may be applied by or on behalf of a public road controlling authority for the purposes of ... planning, design, supervision, construction, maintenance, or operation of a new road..." (section 46(1) LTMA). It is worth noting that, given the definition of "road" and "public road controlling authority" as referred to in section 46, the ability to seek a tolling order relates only to a public sector roading agency for the purposes of a public road. There is no ability for a private sector party to seek its own tolling order. Private sector involvement must be specifically authorised under the Act.

The legislation clearly contemplates public sector tolling of new public roading projects. While there are conditions and requirements that must be met before a tolling order will be granted (many of which

are discussed in the constraints section below), the Act now makes public sector tolling a real alternative to traditional funding mechanisms. This is demonstrated by the recent Ministerial decision to grant approval for ALPURT B2 to proceed as a road toll scheme with Transit being the road controlling authority, the toll operator, and the enforcement agency.

The Act does allow a public road controlling agency to enter into a PPP for a 35 year term which involves the leasing of land, provided that it is done through a concession agreement and Ministerial approval in principle has been obtained. It is interesting to note that the restriction only applies to situations where land (whether owned by the road controlling authority or not) is leased to the private sector agency. While this will be the normal situation, it does leave open the possibility of the private sector agency acquiring the freehold land needed to construct the new road and then entering into an agreement with the relevant road controlling authority to promote the development of the road. However, the road would need to be owned and operated as a private sector road which is unlikely to be realistic on what will be, in effect, major pieces of public infrastructure.

## **6.2 Land Transport Management Act Constraints to Private Sector Involvement**

The Act provides a number of constraints on the effectiveness of private sector participation in new roading schemes. While a number of these are minor, there are at least three significant constraints. Further, the culmination of the constraints provides a significant disincentive to private sector involvement in roading projects.

The three key constraints of the Act to private sector involvement are as follows.

- (a) The inability to toll existing infrastructure. This is a particular problem given that our strategic roading network has been constructed on a piecemeal basis as and when funding and regulatory approvals became available. This means that there are very few places where we are in a position to develop a new piece of contiguous infrastructure. Instead, it is often linking into another piece that was built several years (or decades) ago or needs to link into a future stage as funding becomes available. (A good example of this is SH20 which has been constructed a few kilometers at a time.) Arguably, the whole strategic route should be operated and tolled as a whole. This will not only maximise revenue but will also ensure consistency of operation and demand management. The Act provides for the tolling of an existing road that is located near and is physically and operationally integral to the new road (section 48(2)). However, it is hard to imagine that this section would be interpreted to allow major sections of existing road to be tolled. It is more likely to apply to short linking sections at either end of the new infrastructure.
- (b) The requirement that a “concession agreement must not include any provision that provides a disincentive for a person to pursue other sustainable transport options (for example, public transport or the implementation of demand management strategies)” (section 56(6)). The purpose of a PPP is to provide a new piece of roading infrastructure in the way that provides best value to the public sector and specified benefits. In order to do this, the private sector must be satisfied that, after taking into account all of the risks that it must bear, it can make a profit. In other words, both parties need it to be a “success” in terms of meeting their respective objectives. This section however, could see the following types of provisions interpreted as a disincentive:
  - Many PPPs will require public sector funding contributions either by way of an upfront capital contribution or through an ongoing subsidy payment. The latter can be achieved

through a “shadow tolling” type arrangement which requires the public sector to effectively pay the toll on behalf of the motorist up to a certain assumed traffic volume. It will arguably be in the public sector’s best interests for use of the road to exceed that limit if it reduces the public sector’s financial liability. This may be considered a “disincentive” as it will discourage the development of alternative routes and modes. It could be assumed that the public sector agency will make decisions to the detriment of alternative transport modes in order to maximise use of the road and as such, minimise its financial liability.

- Compensation provisions if traffic volumes fall below a certain level. A concession agreement will often have a risk sharing profile around predicted traffic numbers. The private sector will take a certain level of risk but in order to make the project more financially viable the public sector may take the risk of volume dropping below a certain level, particularly where this is due to other developments that the public sector has control over (such as rail developments). This is commonly referred to as a “material adverse effect” provision requiring the public sector party to compensate in the event that traffic volumes fall below the prescribed levels. For the reasons set out above, it could be seen as a disincentive.
- Assurances regarding the introduction of competing routes and modes. If the public sector wishes to place greater risk on the private sector for traffic volumes, the private sector will want some assurances about public sector decisions on promoting directly competing modes and routes. This type of requirement will almost certainly fall foul of the “disincentive” provision.

This provision, therefore, requires the private sector to assume a substantial amount of risk for elements that remain within the public sector’s control. It also provides a mixed message: we want your money to develop roading infrastructure that we can’t afford, but we want the ability to able to ignore sunk costs and seek to reduce roading demand.

- (c) The third key constraint relates to the consenting and approval processes (see also the table in Appendix 1). This is perhaps the biggest disincentive to private sector involvement. The consenting/approval process by which a concession agreement for a toll scheme can be granted is quite simply too hard, too expensive and too uncertain to be seen as genuinely encouraging private sector involvement. Whilst the Government has passed legislation allowing toll schemes and PPPs there are simply too many hurdles for the private sector to clear to make this legislation truly effective.

The first key aspect is the level of public consultation required, particularly if the project is not on National Land Transport Programme. In that case, the Minister must be satisfied that there is “a high degree of support from the affected communities” for the activity. This provides a considerable degree of uncertainty. What is the extent of the affected community? The definition is:

*“A group of people who are affected by the proposed activity because of living, studying, or working in the close geographical proximity to the proposed activity”*

It doesn’t include people who will use the road to access recreational facilities or people to travel along the road for work (such as commuter and freight operators) but who don’t live or work in close proximity. It also doesn’t address the impacts on users of other roads who might benefit from the new facility being available because of improved traffic flow. The focus is really on environmental type issues that are best addressed in the RMA processes rather than the need for the project or the benefits of having a private sector party involved. Further, why should a higher level of support be required than when decisions are being

made to provide public sector funding in terms of the National Land Transport Programme approval processes?

The other key aspect is the Ministerial approval process for both tolling schemes and concessions agreements. If a PPP is to be tolled then Ministerial approval and an Order in Council is separately required for both (although presumably they could both be obtained at the same time). The LTMA provides for a Ministerial approval in principle for a concession agreement which is intended to provide certainty at an early stage for private sector parties. However, the key problem is the ability of the Minister to impose any conditions he or she sees fit. Further, the concession agreement cannot be signed until the Minister has confirmed that he or she is satisfied that the conditions have been satisfied. This gives the Minister far too much discretion and means that the private sector will need to expend a great deal of money developing the project without any certainty that final approval will be given. In the absence of a clear understanding of what conditions will be imposed and the requirements for satisfying them, it is quite possible that private sector parties will not be prepared to put their own money at risk until the order is obtained.

The effect of these three key restraints will be, at best, to reduce the amount of financial commitment that the private sector will invest into a public roading project. This will increase the public subsidy required. At worst, it will dissuade the private sector from becoming involved in a PPP project.

Although not insurmountable, there are a number of other constraints in the legislation that will have an impact on the appetite of the private sector to fund projects. Briefly, these are as follows.

- The need to provide a free alternative feasible roading route. A big danger to a PPP is the threat of lengthy legal challenge over whether the alternative route contemplated is in fact “feasible”.
- The maximum 35 year term of the concession is a risk in the current New Zealand environment where the impact of road tolling on demand is still unclear.
- The land and road must remain in public ownership. This may not be, from a tax and accounting perspective, as financially favourable to a private sector party.
- There are potential tax problems that have not been addressed in the legislation. While the tax implications are a highly specialized area which should be the subject of further detailed advice, the broad areas of concern are:
  - (a) the ability to claim a depreciation tax expense when some of the infrastructure has been paid for with a public grant. A general tax principle is that a grant is not taxable income and as such, assets purchased or developed with it cannot be depreciated for tax purposes. Where some of the roading infrastructure is paid for by public sector funding, this will have implications for the concessionaire’s depreciation regime. .
  - (b) the manner in which the reversion to the public sector agency will be treated at the end of the term. Presumably, the concessionaire’s interest in the road and improvements will revert to the public sector at zero-cost. How will this be treated for tax purposes in the hands of the concessionaire and how does this fit into the depreciation regime?
  - (c) the way in which the leasehold interest will be valued and treated for tax purposes.

### **6.3 Resource Management Framework**

One of the big difficulties to getting best value out of private sector involvement is due to our resource management framework. There are often a multitude of regulatory consents needed which require a

high level of project specificity and design. For example, obtaining a designation for a new roading project requires a detailed option analysis, a specimen design, and a detailed assessment of environmental effects.

The traditional view is that the consenting risk is best managed by the public sector. This has limited private sector involvement to post-consenting activities. By this stage much of the value of private sector participation in terms of generating efficiencies and innovation has been lost. There is definitely therefore, a need to look at a new approach to consenting roading projects.

Many commentators have pointed to a systemic problem with the Resource Management Act as the cause of delay and the difficulties in getting the private sector involved. A more permissive legislative environment would produce significant benefits, but there is the potential under the current framework to improve the situation. In particular, while there is a common view that the public sector are best placed to manage the consenting processes, this is open to challenge. Public sector agencies are more susceptible to challenge and through political pressures will often go further in terms of consultation and stakeholder liaison than is necessarily required under the legislation. Arguably the private sector can take a more robust and streamlined approach to consenting. The private sector also has a good history of being able to obtain consents for major infrastructure developments.

There is the ability for a private sector party to initiate designation proceedings for roading projects provided they are a network utility operator (which they will be where they are involved in the development of a public work) and they receive Ministerial approval for requiring authority status. The definition of network utility operators includes someone who constructs, operates or proposes to construct or operate a road. Given that a number of private companies have that status, there is a strong precedent for application in roading situations. Requiring authority status could be obtained as part of the Ministerial approval in principle of the concession. It should also be noted that the Resource Management Act provides powers of compulsory acquisition.

It is suggested that the private sector should be brought into the development of major roading projects at a much earlier stage and that there is a role for them to play in consenting for the project. This will provide early input into option development, design, negotiation of consent conditions, and the potential for a more pragmatic approach to land purchase. It does raise some risks however including:

- How do you select the best concessionaire at such an early stage?
- How are costs managed during the development phase before a concession agreement can be executed and the arrangements brought to a financial close in terms of the concessionaires debt and equity funding arrangements?
- What if the concessionaire cannot achieve financial close?
- What happens if the Minister's decisions on risk allocation in the Order in Council make the project unattractive for the private sector?
- At what stage is the project put through a public sector comparator and what happens if it comes out in favour of a public sector procurement model?

All of these risks will need to be addressed. However, in principle, there is nothing to stop early private sector involvement and in fact, it brings with it a considerable number of benefits.

There are though, difficulties with the current consenting regime. In particular, the current process of having a Notice of Requirement (NOR) go through a territorial authority, which makes a recommendation to the requiring authority, before the requiring authority makes its own decision could be improved. Direct referral to the Environment Court would avoid the NOR being considered in full at two hearings (assuming appeal on major or controversial projects).

There is also the risk of incurring significant delay and additional costs due to the need to obtain further environmental consents after the land use has been approved through the designation process. These regional council consents can include coastal marine, earthworks, and ground water consents, and will often involve a considerable amount of “horse trading” on conditions. Further, on major projects these consent applications are often notified and provide another opportunity for opponents of the project to seek to stall or stop it. A more effective process would be to deal with all environmental matters by way of management plans with a clear set of criteria as to what needs to be addressed. In other words, the designation approves the project and all environmental matters are then addressed at a technical level.

## 6.4 Conclusions

The current legislative framework provides significant disincentives to the development of PPPs. The risks and uncertainties it causes can significantly reduce the value of that involvement. The result is that the public sector will end up paying through increased subsidies and the inability to take advantage of the efficiencies and innovations the private sector can bring. The only real solution is legislative change to address the constraints inherent in the LTMA. However, there are ways that PPPs could be encouraged under the current legislative framework. These are discussed below.

### Options

Options to encourage the appropriate use of PPPs under the current framework are as follows:

- Develop a clear policy framework which determines when best value for money will be obtained by private sector involvement.
- The policy framework needs to provide clarity on the ability to toll existing infrastructure (as provided for under section 48(2)) and the types of assurances that will fall foul of the “disincentive” provisions contained in section 56(6).
- Develop alternative methods of advancing roading projects through the regulatory processes with more emphasis placed on land ownership and early involvement of the private sector parties. There is already some experience of this with alliancing. The possibility of extending this to the consenting stage with the involvement of the private sector consortium needs to be fully explored.

There are statutory options that can be explored in parallel to the above approaches. These involve:

- Amending the Resource Management Act to provide a more streamlined and permissive environment for major roading projects. One approach would be to provide for an “umbrella consent” which approves the project with all other matters dealt with under management plans. This means that only one consent is required.
- Remove or significantly amend the disincentives to PPPs in the Land Transport Management Act that are discussed above.

## 7. Integration of PPPs with Road Pricing

One final issue worthy of consideration is how PPPs which involve the private sector collecting real tolls might be integrated with some form of more general road pricing. This is a potentially serious consideration as one of the initiatives coming out of the Government’s transport funding package “Investing for Growth” is an investigation, by the MoT, of the desirability and feasibility of introducing some form of road pricing in the Auckland region.

The potential integration issues will include pricing and revenue effects. If the toll scheme's pricing cannot be integrated with that of complementary routes this might negate to some extent the effectiveness of road pricing. The concessionaire may seek compensation where traffic volumes are reduced or may make super profits where volumes increase after the introduction of road pricing. However, these matters could be dealt with in the contracts negotiated with a concessionaire.

On the other hand, the advantage of introducing toll schemes, whether publicly or privately operated is that they provide an incremental step towards a broader road pricing mechanism. The United Kingdom Government has signalled an intention to move towards a national road pricing scheme and as part of that process acknowledges that private toll schemes, such as the new M6 Expressway, are a key part of that strategy and not an impediment.

## 8. Conclusion

Under the right conditions Public-Private Partnerships can and do deliver better value for money than traditional public sector delivery models. For example:<sup>20</sup>

- The National Audit Office in the United Kingdom examined a number of privately financed projects and concluded that seven of the projects provided a saving of £900 million with the total value of the project being £3.6 billion.
- The UK Treasury Task Force examined a sample of 29 projects and concluded that they provided an average cost saving of 17% over public sector delivery.

International experience has shown that under the right conditions PPPs can capture the following benefits:

- The opportunity for project risks to be allocated to those best incentivised to manage a particular risk
- The opportunity to secure whole of life asset management
- More cost efficient provision of project/parts of project
- Higher quality provision of project/parts of project
- Value added through innovation, project synergies (Specification of outputs rather than inputs promotes innovation)

However, in order to ensure a successful outcome we consider that it is important that due consideration is given to managing the following issues associated with PPPs:

- High transactions costs arising from complex processes and the need for highly skilled resources to develop, manage and monitor projects
- Risk of being locked into an inflexible long-term contractual arrangement with only one opportunity to negotiate
- Risk of compromising future network development (because of contractual limitations)
- The potential for public sector borrowing to appear relatively cheaper than private sector finance when the true cost of the public sector retaining project risks is overlooked

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<sup>20</sup> Private Financing of Public Assets: Practical and Policy Problems (2004), Robert Lonegran

However, internationally, the public sector is increasingly turning to the private sector for assistance in dealing with an increasing infrastructure funding gap. The challenge facing Government's is to create the 'right environment' to enable the potential of PPPs to be fully realised.

New Zealand has opened the door for private sector involvement in roading with the introduction of the Land Transport Management Act. The Act allows for the establishment of a road tolling scheme and a private sector concession agreement by Order in Council, on Ministerial recommendation.

The conclusion of this paper is that the Act includes a number of constraints on the effectiveness of private sector participation in new roading schemes. While a number of these are minor, there are at least 3; the inability to toll existing infrastructure, the requirement that a concession agreement must not include any provision that provides a disincentive for a person to pursue other sustainable transport options and the consenting and approval processes, the culmination of which provides a significant disincentive to private sector involvement in roading projects.

The United Kingdom and Australia (through the States of Victoria and NSW) have developed comprehensive policy frameworks to evaluate the value for money of a PPP when compared to the public sector alternative. A key recommendation of this paper is that to effectively utilise PPPs New Zealand must follow the examples set by Australia and the United Kingdom. Providing one Government Agency with a leadership role, as occurred in the UK and Australia could well assist this process.

Overall, the current legislative framework provides significant disincentives to the development of PPPs and the prospect of a successful PPP being implemented under the current legislation is unlikely. The only real solution is legislative change to address the constraints inherent in the LTMA.

# Appendix 1: Process and Requirements for Obtaining Ministerial Approval for a Tolling Scheme and Concession Agreement

## 1. Steps to Gain Ministerial Approval for a Tolling Scheme

Requirement	Detail	Issues
Overall - Development of tolling scheme	Sufficient detail will be needed to satisfy the consultation and application requirements of the LLTMA	A significant amount of time and cost is likely to be incurred developing a project as a potential toll scheme before there is any certainty that it will be approved by the Minister
Consultation	If the “activity” is not included in the NLTP, then a “high degree of support from affected communities” must be demonstrated	What is the definition of “activity”? Is it the roading activity or the tolling activity? Imposing a higher threshold for acceptance than needed for inclusion into the NLTP appears discriminatory.
Application for Order in Council	Significant detail is required in order for a Minister to make a decision including: <ul style="list-style-type: none"> <li>• How the activity contributes to the purpose and principles of the Act</li> <li>• The availability of alternative transport options and the impact of the activity on those options</li> <li>• Consistency with current transport expenditure priorities</li> <li>• Outcome of consultation</li> <li>• Existence of a feasible, untolled, alternative roading route.</li> </ul>	In combination these requirements create significant uncertainty.
Ministerial Approval – Order in Council	May specify details/requirements on: <ul style="list-style-type: none"> <li>• The level of tolls</li> <li>• Grant exemptions</li> <li>• How the tolls are to be collected</li> <li>• Requiring a demand management plan to be prepared</li> </ul> The approval can be subject to any conditions.	There is uncertainty about when and how the Minister will use these powers. The ability to impose conditions is very broad.
Ministerial Confirmation of Satisfaction of Conditions	The Order is required to set out a process by which the Minister will confirm whether he or she is	

	satisfied that the conditions have been met.	
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## 2. Steps to Gain Ministerial Approval for a Concession Agreement

Requirement	Detail	Issues
Development of scheme	Sufficient detail will be needed to satisfy the consultation and application requirements	A significant amount of time and cost is likely to be incurred developing a project to this level before there is any certainty that Ministerial approval will be given.
Consultation	If the “activity” is not included in the NLTP, then a “high degree of support from affected communities” must be demonstrated	What is the definition of “activity”? Is it the roading activity or the private sector involvement? This is imposing a higher threshold for acceptance than is needed for inclusion into the NLTP eg. Non-tolled projects. Defining the ‘affected community’ is fraught with uncertainties.
Application for Order in Council	Significant detail is required in order for a Minister to make a decision including: <ul style="list-style-type: none"> <li>• How the activity contributes to the purpose and principles of the Act</li> <li>• The availability of alternative transport options and the impact of the activity on those options</li> <li>• Consistency with current transport expenditure priorities</li> <li>• Outcome of consultation</li> </ul>	In combination these requirements create significant uncertainty.
Ministerial Approval in Principle – Order in Council	Minister must set conditions protecting public access to the new road.  Minister may make any conditions the Minister thinks fit including: <ul style="list-style-type: none"> <li>• Apportionment of risk</li> <li>• Responsibilities of the parties</li> <li>• Rights of the parties</li> </ul>	There is uncertainty about when and how the Minister will use these powers. The ability to impose conditions, which affect the viability of the scheme, is very broad.  These conditions will form part of the concession agreement.
Ministerial Notification That Conditions Have Been Met	Required before the concession agreement can be executed	Provides considerable uncertainty as to whether final Ministerial approval will be forthcoming
Execution of Concession Agreement		Cannot formalise arrangements until late in the process