

Media Release
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WEIGHT OF INTERNATIONAL EXPERIENCE SHOWS PUBLIC PRIVATE PARTNERSHIPS ADD VALUE FOR PUBLIC

The New Zealand Council for Infrastructure Development is urging the Government to look more closely at utilizing PPPs to help advance public infrastructure development throughout the country.

"NZCID's core role is to undertake substantive research into international best practise in infrastructure development. As a result of this work, we consider there is real potential to utilise public private partnerships to speed up construction and improve services of key public infrastructure " says NZCID Chief Executive, Stephen Selwood.

"Internationally PPPs have been highly successful in the development and renewal of schools, hospitals, courts, street lighting, water services, waste, recycling and telecommunications - the range is immense.

"This is not privatisation of public assets but true partnership between the public and private sectors to improve core public infrastructure.

"PPPs have developed as one of the most important tools governments can use to improve services and close the infrastructure gap but, as yet, have had little application in New Zealand," Selwood says.

"While unlikely to fully replace traditional financing and development of infrastructure, PPPs offer several benefits to governments trying to address infrastructure shortages or improve efficiency: the injection of private finance means that more projects - roads, schools, hospitals, courts, prisons, can be built sooner than traditional "pay as you go" public sector procurement the public sector is able to focus on core services, like teaching the kids, healing the sick, or moving people and goods on high quality roads and public transport systems while the private sector maintains the assets the private sector takes on the risks of design, construction and long term maintenance of the infrastructure. If there's cost blow-outs, they have to bear those costs. Having an ownership stake in the asset means that the private sector is highly incentivised to design, build and maintain the asset to the highest standard that will endure over its entire life private sector skills in innovation in design, construction, asset management and ongoing maintenance are brought to the fore in a competitive tender process that provides improved value over time extra revenue is often generated to offset costs by using the infrastructural assets in an innovative and commercial manner (e.g. on-site day care, night classes in idle classrooms, tolls on roads)

"The costs in productivity losses resulting from inadequate infrastructure are immense. It is well known that every years delay in redressing congestion in Auckland costs the national economy in excess of \$1 billion. Substandard national and regional highways result in poor safety standards, delays and discomfort and degrade our international standing from a tourism and investment perspective.

"While Government has substantially increased public investment in transport infrastructure, particularly in Auckland, significant funding gaps remain. Obvious

examples where there are major funding shortfalls across the country include completion of the Waikato Expressway, the Tauranga Eastern Motorway, Transmission Gully and north and south motorway extensions in Christchurch, together with Auckland's Western Ring Route, the Auckland Manukau Eastern Transport Initiative and public transport services.

"Taking a partnership approach with the private sector to redress the nation's infrastructure deficit makes good social, environmental and economic sense. We would encourage as much positive dialogue between the government and the private sector as possible to advance solutions to these issues," Selwood says.

NOTES TO EDITORS

A detailed list of reports and information on PPPs is available at the NZCID website:
<http://www.nzcid.org.nz/publicprivatepartnerships1.html>

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Questions and Answers about PPPs...

What are PPPs?

PPPs are a form of long term partnership between the public and private sector to build and maintain public assets. Under a partnership agreement the public sector defines the service standards that must be delivered, monitors their delivery and pays for the service provided. The private sector contractors work in a consortium to finance, design, construct and maintain the asset for a fixed term - usually around 30 years. The contractors ability to recover their investment is totally dependent on meeting the key performance standards for the duration of the contract. If the service is not up to scratch the government withholds payment. At the end of the agreement the contractor hands back the asset to the state in an "as new" condition. Failure to do so results in a penalty.

In a typical PPP project the government would:

- engage one party to design, finance, construct, maintain and, in some cases operate the facility

- only make payments after the facility has commenced operations

- provide payments over the term of the contract based on services delivered against the achievement of key performance indicators "with these payments being at risk for non performance.

It is important to note that the responsibility for delivering core services is retained by government and the project must pass a rigorous public interest test. Good public policy requires that all projects must offer value for money as a government investment, independent of the delivery method. The same is true of PPP projects.

What are the benefits of PPPs?

The key benefits of PPPs are:

- the injection of private finance means that more projects - roads, schools, hospitals, courts, prisons, can be built sooner than traditional "pay as you go" public sector procurement

the public sector is able to focus on core services, like teaching the kids, healing the sick, or moving people and goods on high quality roads and public transport systems the private sector takes on the risks of design, construction and long term maintenance of the infrastructure. If there's cost blow-outs, they have to bear those costs.

having an ownership stake in the asset means that the private sector is highly incentivised to design, build and maintain the asset to the highest standard that will endure over its entire life

private sector skills in innovation in design, construction, asset management and ongoing maintenance are brought to the fore in a competitive tender process to provide improved value over time

extra revenue is often generated to offset costs by using the infrastructural assets in an innovative and commercial manner (e.g. commercial night classes in idle classrooms, tolls on roads)

What's in it for the Private Sector?

PPPs appeal to the private sector because of the long term nature of the contract which attaches long term stable income. It is ideal for superannuation funds looking for long term secure investment opportunities.

Doesn't the need for the private sector to make a profit make PPPs more expensive?

The reality is that almost every state asset in the country is already designed, built and maintained by the private sector. This naturally includes a profit component. Public private partnerships are merely an extension of the concept. There is no extra profit component in a PPP. The only difference is that under a PPP the private sector finances the asset up front and then enters into a long term agreement to recover costs in the form of service payments over the term of the contract.

How does Government make sure its getting value for money?

Value for money is assured by undertaking an objective comparison of the competitive PPP proposals against public sector proposal. Competition between bidders for a whole of life asset and related services provides scope for innovation and other factors to achieve efficiency savings above those achieved under equivalent public sector delivery and financing. A PPP only proceeds where an objective assessment shows better value for money in the PPP model.

What represents better value?

Better value is not just cheaper. It also means the overall outcomes achieved, such as higher quality and better maintained infrastructure over the longer term. It is about obtaining the best deal for government in the delivery of infrastructure across a number of factors, including price, quality of service delivery to the community, design, amenity and sustainability of the arrangement. For instance, compared to traditional built infrastructure, PPPs have provided flexibility and higher quality in design. This has achieved efficiency in operations, reduce maintenance and provide capacity to expand infrastructure to meet future needs without disruption to operations. Competition between bidders and the potential for innovation, which produces savings in operational costs or related commercial opportunities to generate revenue, reduce the overall cost to government.

Why borrow through the private sector? Can't the public sector can borrow more cheaply?

It makes sense for the public sector to borrow to fund critical infrastructure. But it makes more sense to use the private sector when the overall package provides better value for money. Effective application of the PPP model is about packaging projects in a way that

ensures lower overall cost to the state and improved services to the community. Competition between bidders for a whole of life asset and related services provides scope for innovation and other factors to achieve efficiency savings above those achieved under equivalent public sector delivery and financing.

It is a myth that the value for money outcomes achieved in PPP projects are compromised by higher private sector borrowing costs. The Government's ability to borrow more cheaply is purely a function of its capacity to levy taxes to repay borrowings. Credit markets perceive this power as reducing the risk of their investment and therefore will lend to government at lower rates. However, when it comes to raising finance for a project, it is the risk of the individual project that determines the real cost of finance. The difference between the private and the public sectors is that private sector capital markets explicitly price in the risks of a project into its sources of finance. This is not the case in the public sector. Instead, taxpayers implicitly subsidise the cost of the project by bearing the risk of cost overruns, time delays or performance failures, which are not priced into the Government borrowing rate.

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

Aren't PPPs just a means to take expenditure off the Government's Balance Sheet? The balance-sheet treatment of a project is not the driving force behind the use of a PPP delivery approach. In most jurisdictions PPP projects are included on the Government's balance sheet (and the accounts are audited each year). The decision about how a project is funded is separate to the decision of how it is delivered. PPPs compete for budget funding along with all other capital projects. Full capital budget funding is set aside for non-self funding projects before market interest is formally sought, allowing a project to proceed to traditional delivery should private bidders not offer value for money.

Does real or effective risk transfer actually occur?

A common view is that value for money is compromised through risk transfer not being real or not being any more effective than the traditional delivery of infrastructure. PPP projects assign risks to those best able to manage them, avoiding excessive premiums for inappropriate risk transfer, and in reality, what is transferred is the financial consequences of risk occurring. Construction costs are just one example where government can significantly benefit from transferring the risk of cost overruns to the private sector. However, there are many other areas where the risk transfer is real, including maintenance and fit-for-purpose design.

But aren't PPPs expensive to negotiate?

International experience including adopting standard commercial principles in PPP projects and increasing the use of the interactive tender process in projects has reduced the time and cost of PPP contracts significantly.

Won't long-term PPP contracts unduly lock-in future Governments?

Most infrastructure, by its very nature, is built to last for 20 years or more. No matter what mode of delivery, the government is making decisions that have long-term consequences. The benefit of a partnership approach is that the government will need to consider more fully the whole-of-life issues before entering into partnership arrangements and incorporate sufficient flexibility into the arrangements to take advantage of improvements in service delivery quality and efficiency over time.

Who is the NZ Council for Infrastructure Development?

NZCID is an authority at the forefront of infrastructure development issues. Encouraging best practice in national infrastructure development is a key objective of the NZ Council for Infrastructure Development. The council is a not for profit organisation and important advocacy for and research into infrastructure issues is made possible by our membership. NZCID members come from diverse sectors across New Zealand, equity owners, service providers, public sector agencies, and major infrastructure users; a full list of which is available on our website: www.nzcid.org. Together we share a clear purpose: world class infrastructure for the benefit of all New Zealanders. A goal we are committed to achieving by:

Raising awareness of the fact that infrastructure underpins our community's quality of life and that inadequate infrastructure holds back New Zealand's economic and social growth

Generating valuable debate on the quality and level of infrastructure provision to meet New Zealanders' needs

Encouraging the implementation of best practice infrastructure provision and management

Identifying the condition of New Zealand's infrastructure and the challenges facing our infrastructure providers

Further information on infrastructure development, NZCID and its members can be found at: www.nzcid.org.nz