



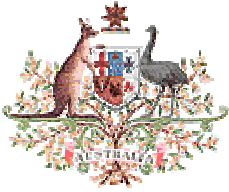
Senate Foreign Affairs, Defence and Trade References Committee

Submission on the Benefits of Public Private Partnerships to

Inquiry into Materiel Acquisition and Management in the Department of Defence



June 2002



Executive Summary

This submission is given to the Senate Foreign Affairs, Defence and Trade References Committee in response to the Inquiry into Materiel Acquisition and Management in the Department of Defence.

This paper details the significant benefits that the development of Public Private Partnerships (PPP) projects can deliver Government, Defence, and the Australian taxpayer.

PPP, as well as delivering significant value for money to Government, also ensures absolute transparency in respect of project evaluation:

- PPP requires the identification of all whole of life risks and costs.

Risk transfer and value for money is delivered to Defence through PPP:

- Defence never pays for a project until it is successfully delivered and meets Defence's requirements.

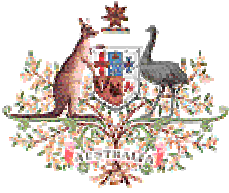
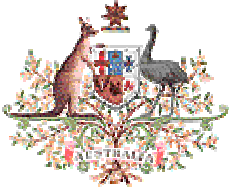


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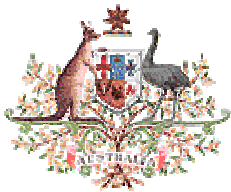
ABN AMRO

The Global Bank :



Australia and New Zealand :





ABN AMRO Australia and New Zealand : Our Services

Public Sector

Telecommunications, Media & Technology

Diversified Industries

Energy, Chemicals & Pharmaceutical

Financial Institutions

Corporate Finance

Corporate Advisory, Project Advisory, Capital Structuring, Private Equity, Equity Capital Markets JV (ABN AMRO Rothschild).

Equities

Sales, Trading, Research, Equity Derivatives. Private Client Services through ABN AMRO Morgans and ABN AMRO Craigs.

Global Financial Markets

Origination, **Infrastructure Capital**, Trading and Distribution in bonds, money market, derivatives, foreign exchange, futures.

Loan Products

Corporate Lending, Asset Based Finance, Project Finance, Structured Trade Finance, Agency, Mortgage Finance.

Asset Management

ABN AMRO Family of Funds - international coverage of equity and bond markets in eight global, regional and country funds.



Major Transactions undertaken by ABN AMRO



ABN AMRO acted as the Global Coordinator in Telstra I and the Leading Global Coordinator in Telstra II. ABN AMRO (the former BZW) was also Financial Adviser to OASITO in Telstra I.



ABN AMRO advised the OASITO on the \$4.1b sale of 17 Australian airports (including Melbourne, Brisbane and Perth).

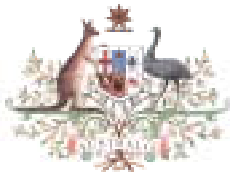


ABN AMRO acted as the Joint Lead Manager in the A\$1b IPO/Privatisation of the NSW TAB.

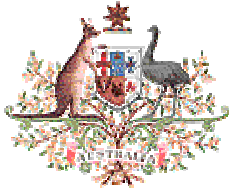


CONNECT

Leading the Connect Consortium's bid for Sydney Airport



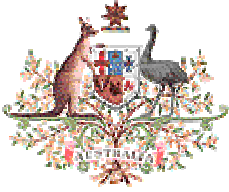
ABN AMRO acted as Joint Arranger and Debt Underwriter to a consortium that bid on the acquisition of \$500m of property offered for sale by the Commonwealth. We were successful in 2 of the 4 packages at a price of approximately \$250m.



ABN AMRO Infrastructure Capital Experience in PPP

Transaction	Year	State	Sector	Construction LC / Finance	Long Term Debt	Equity	Rating
Department of Education, Tamworth	1992	NSW	Property	-	25 year CPI annuity bonds	-	AAA
Adelaide Tax Office	1993	SA	Property	-	\$40.9 mln fixed rate annuity bonds \$11.8 mln zero coupon bonds	-	AAA
Burnie Hospital	1994	Tas	Health	-	\$19 mln 15 year CPI Indexed Annuity	Yes	AAA
Mount Gambier Hospital	1997	SA	Health	Yes	\$23.75 mln 27 year CPI indexed Annuity bonds	Yes	AA
Port Augusta Hospital	1996	SA	Health	Yes	\$21mln 27 year CPI indexed Annuity bonds	Yes	AA
La Trobe Hospital	1997	VIC	Health	Yes	\$40 mln 16.5 year CPI indexed Annuity bonds	Yes	A-
EDS	1997	SA	Property	Yes	\$60 mln 17 year Fixed Rate Annuity bonds \$5 mln 17 year zero coupon bond	Yes	AA
Royal Hobart Hospital	1998	TAS	Health	Yes	\$42.5 mln nominal bonds	Yes	unrated
La Trobe University Medical Centre	1998	VIC	Health	Yes	\$25 mln 16 year Annuity bonds	Yes	AA-
Airtrain	1999	Qld	Rail	Yes	\$105 mln 33 year CPI Annuity Bonds	-	Baa3
Australian Defence Industries	2000	VIC	Defence	-	\$153 mln Senior 15.25 year Fixed Annuity Bonds \$53 mln subordinated 15.25 year Fixed Annuity Bonds	-	Aaa/ unrated
Fremantle Justice Complex	2000	WA	Justice	Yes	\$17 mln 25 year fixed rate annuity bonds	Yes	Aaa
County Court of Victoria	2000	VIC	Justice	Yes	\$136 mln 22 year CPI linked annuity bonds \$6.9 mln 23 year zero coupon bonds	Yes	Aa2
Mildura Base Hospital	2000	VIC	Health	-	\$46 mln fixed rate annuity bonds	Yes	A1
CSIRO	2001	NSW	Property	Yes	\$133 mln 20 year nominal indexed annuity bonds	Yes	AAA
Cairns Waste Management	2001	QLD	Waste Management	Yes	\$32.5 mln fixed escalation annuity bonds	-	A1
Parramatta Police Headquarters	2001/ 2002	NSW	Property	Yes	\$85 mln 20 year fixed escalating annuity bonds \$80 mln interest only fixed rate bullet bonds	Yes	AAA

- PPP is not new to Australia
- ABN AMRO Infrastructure Capital has over 10 years relevant experience.



What is PPP ?

Public Private Partnerships:

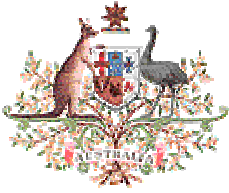
- A partnership which leverages respective skills of public and private sectors
- For the delivery of infrastructure and other capital assets
- Government responsible for core services
- Looks to extract private sector efficiencies in design, construction, operations and maintenance
- Risk allocated to party best able to manage it
- PPP delivers
 - value for money
 - transparency; and
 - accountability
- Assessment of value for money the key determinant and benefit of PPP
 - Accurate assessment of value for money must reflect project risk



Benefits of PPP for Defence

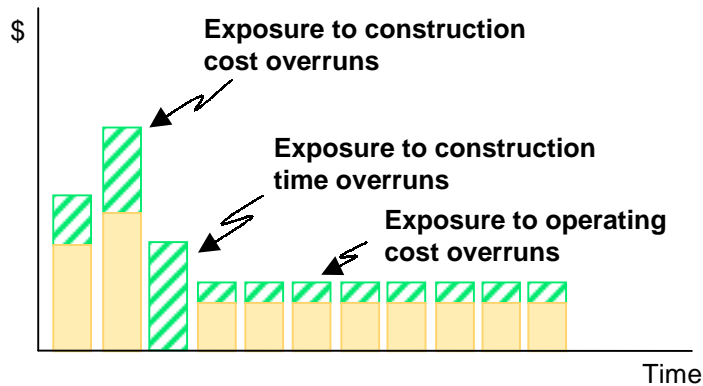
Defence will only pay for a project delivered by PPP when it is available and/or used by Defence:

- Defence has a history of delivering projects:
 - over budget
 - late
- PPP projects are delivered:
 - on time, if late the private sector pays damages
 - to budget, if over budget the private sector wears the loss
- PPP assists Defence and Government identify whole of life project costs
 - Once identified then locked down by contract



PPP vs Traditional Procurement

Traditional Public Funding



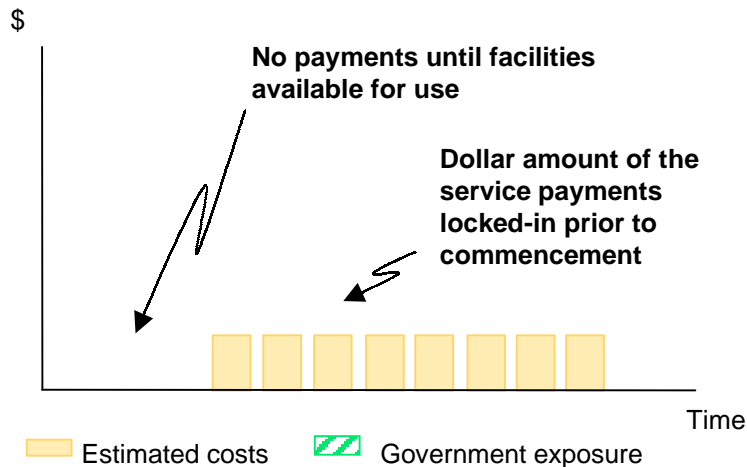
Traditional procurement, Defence pays for a project progressively as it is delivered:

- with no certainty it will work on completion;
- history points to substantial cost blow outs;
- substantial delays; and
- substantially higher operating costs.

PPP projects ensure Defence does not pay for a project until:

- it has been completed;
- performs to specified outcomes/KPI's; and
- is well maintained and operated.

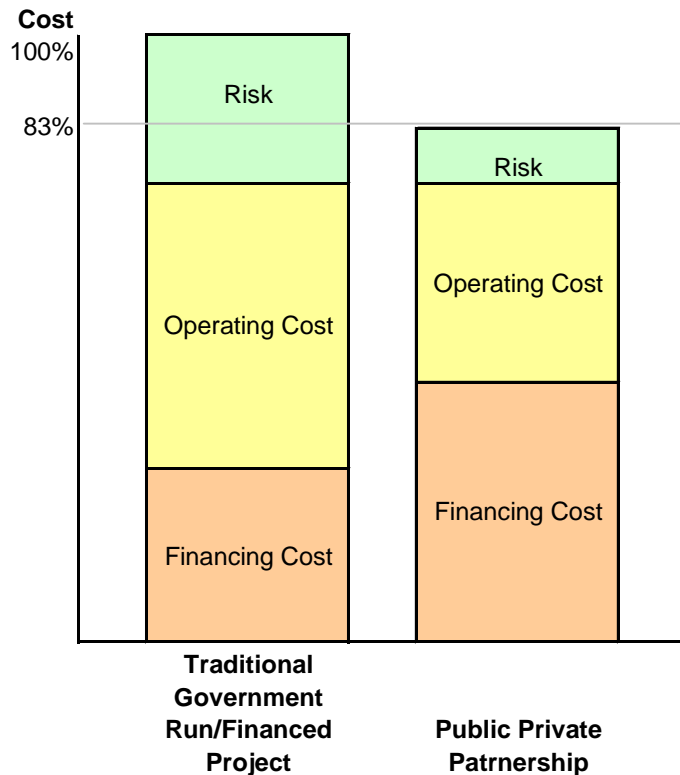
PPP Funding Approach



Given payment structure, private sector incentivised to delivering a project that works for 20-30 years, not just on the day completion is certified.

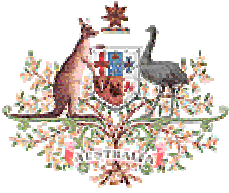


PPP vs Traditional Procurement cont...



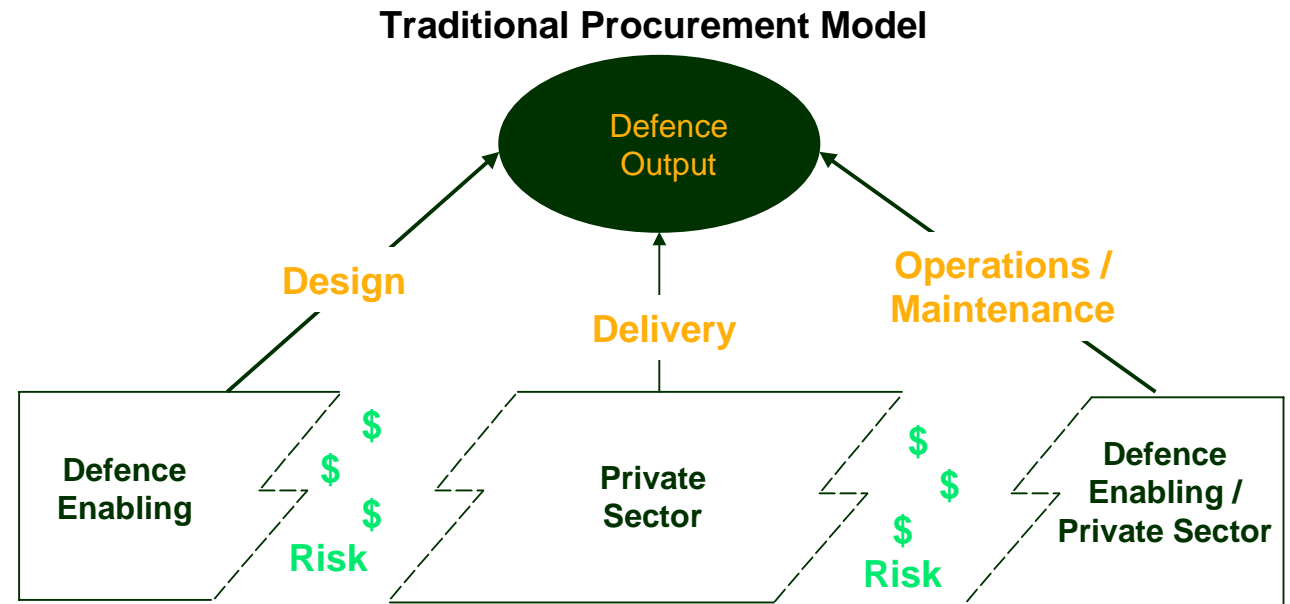
- Private sector capital is more expensive than cost government's cost of funds;
 - government's cost of funds reflects taxing capacity not a project's risk.
- However, private sector capital prices project risks;
 - construction risk (budget and delay)
 - operations risk; and
 - maintenance risk.
- Arthur Andersen* compared the total cost (Net Present Cost) of 29 PFI projects in the UK, with the estimated cost of the public sector undertaking those projects itself, including an estimate of the risk that would have been retained by the public sector. The results strongly supported the PFI approach, as follows:
 - None of the 29 projects was estimated to have had a lower overall cost under conventional public procurement;
 - The average percentage saving by adopting the PFI approach was 17%;
 - Risk transfer valuations accounted for 60% of the total savings.

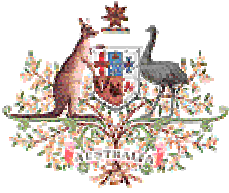
* Source: *Value for Money Drivers in the Private Finance Initiative*, Arthur Andersen and Enterprise LSE, January 2000.



PPP vs Traditional Procurement cont...

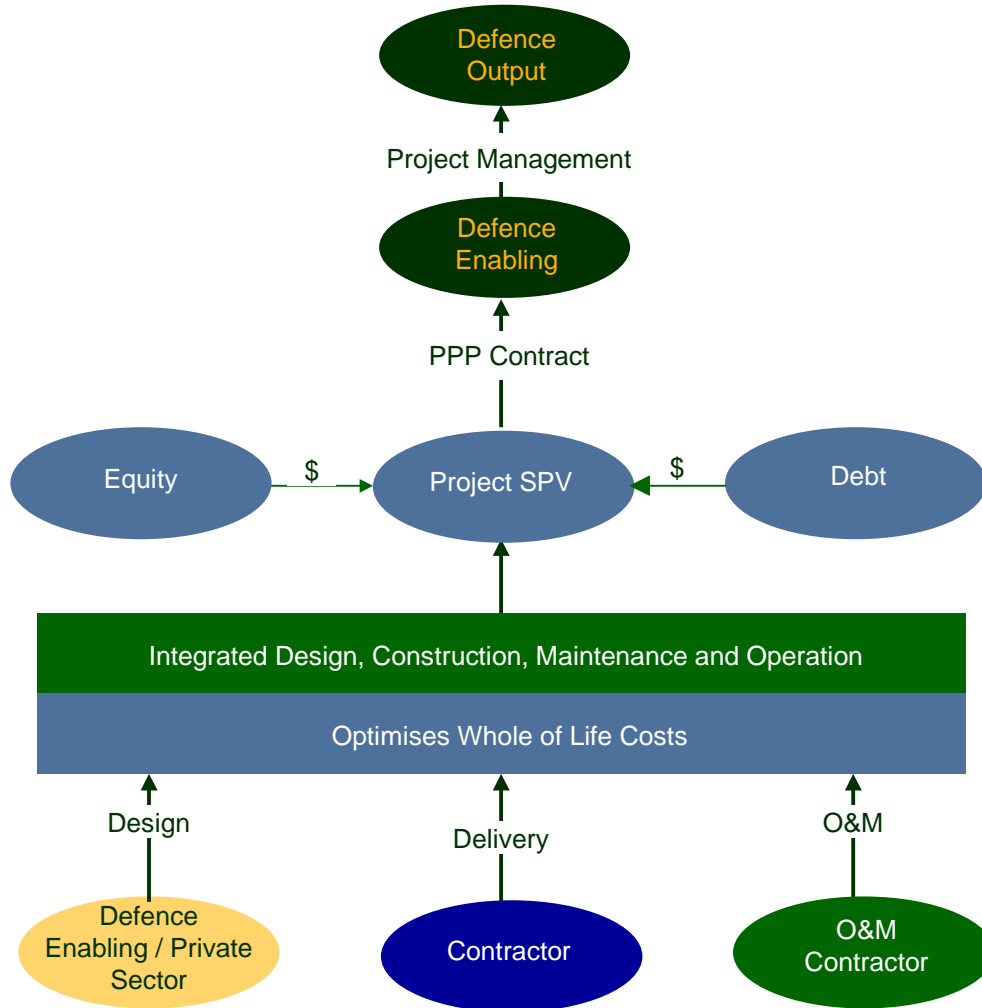
- Defence projects typically highly specified / designed by Defence, rather than outcomes based
- Private sector contractor blames poor design/specification for delivery problems
- Operations / maintenance providers fault design and/or quality of construction
- The result, delays, cost over runs and poor operating performance as risk “slips through the cracks”



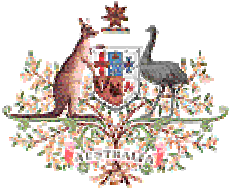


PPP vs Traditional Procurement cont...

PPP Procurement Model



- Defence Enabling project manages on behalf of Army, Navy, Airforce etc
- Defence Enabling purchases a service, on basis of availability and/or usage
- Private sector delivery of integrated project - only get paid if project is available and/or used
- Marrying of design and life cycle costing
- Defence only have 1 point of contact
 - No “cracks to slip through”
- Introducing banks and institutional investors into the contract negotiation process:
 - due diligence
 - contractual and financial discipline
 - banks stand in front of Government



How Can the Private Sector Add Value?

By delivering value for money

Issue

Linking payment to long term performance of Project.
Appropriately valuing the residual value

Commentary

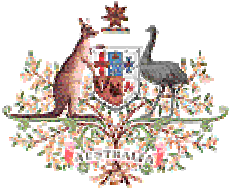
Integrating the design and long term operation and maintenance of a project delivers significant long term savings.

Party best able to price the residual value should take residual value risk.

Example



Victorian County Court



How Can the Private Sector Add Value?

By delivering projects which would not proceed due to budgetary constraints

Issue

Budgetary constraints restrict projects that can be undertaken by Defence

Commentary

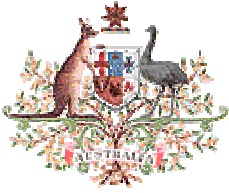
Private Sector Finance can deliver innovative finance solutions which can amortise costs of delivery over very long term

Long term financing also delivers inter-generational equity

Example



Brisbane Airtrain



How Can the Private Sector Add Value?

By accepting transfer of procurement delivery and commissioning risk

Issue

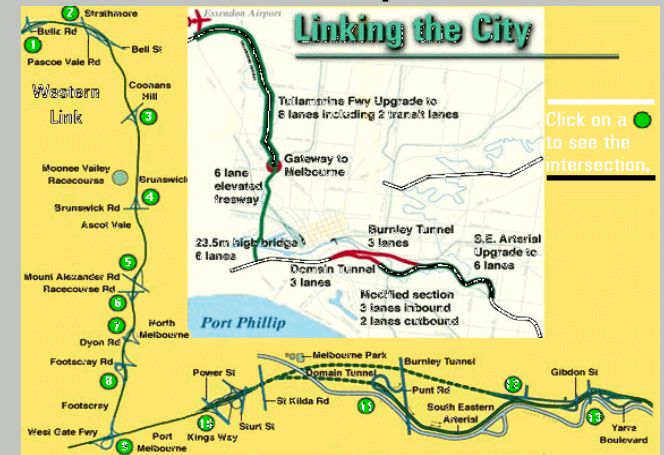
Traditional procurement methodology often results in cost/time overruns

Commentary

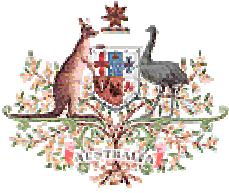
Private Sector responsibility for procurement and commissioning can insulate Government from cost and time overruns

Delivers projects quickly and effectively

Example



Transurban City Link



How Can the Private Sector Add Value?

By allowing Defence control of and unfettered access to, the project.

Issue

Defence often requires that it maintain full control post-commissioning of assets

Commentary

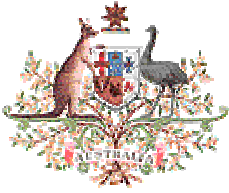
Post-commissioning, financiers rights are limited

Defence can control and have unfettered access to the assets

Example



Mt Gambier Hospital



How Can the Private Sector Add Value?

By financing upgrades, ensuring long term flexibility

Issue

Technological advances can result in assets requiring major upgrades

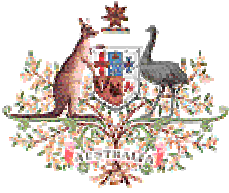
Commentary

Allowance can be made for further funding to be raised to pay for upgrades of the assets

Example



Burnie Public Hospital



Ministry of Defence in UK:

- if it doesn't move, PFI
- if it moves but is behind front line, probably PFI
- if it moves and is at the front line, probably not PFI

Which Projects are Suitable for PPP

- There is a requirement for significant capital investment, say \$20 mln and over
- There is scope for innovation in how the project is delivered
- A competitive market exists for the provision of the services/project
- Appropriate risks that are currently borne by the public sector can be transferred to the private sector
- Long term financing solutions are feasible
- The scope of the project (outputs) can be clearly defined

Suitable Defence Projects

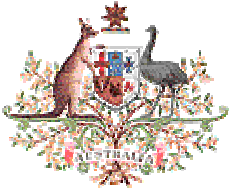
Accommodation: office, commercial and logistics facilities

Defence Housing

Transportation: patrol boats, air to air re-fuelling, personnel movement

Equipment: all non front line equipment particularly simulation and training equipment

IT and Telecoms: HQAT and HF Mod



Issues

Taxation

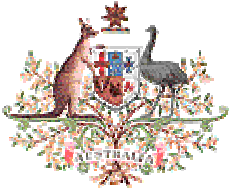
- Section 51AD, in particular, and Division 16D are complexities in delivering PPP's.
- Status of Ralph Report recommendation on abolishment of Section 51AD.
 - ATO Review of Section 51AD by 1 July 2003

Accounting

- Budgets prepared using Government Finance Statistics, compiled by ABS
 - punitive treatment for projects which are assessed as finance leases
 - result is completely at odds with Generally Accepted Accounting Principles
- Benefits of PPP occur regardless of accounting treatment
 - value for money still achievable given integrated design, construction, maintenance & operation and identification of whole of life costs
- Majority of PPP projects will always be “off balance sheet”
- However, risk of finance lease classification will kill many deals that otherwise deliver significant value for money

Public Sector Comparator

- Appropriate for PSC to reflect most efficient public sector delivery option
- However, must be achievable and PSC must appropriately reflect project risk.



Conclusion

- Adoption of PPP for suitable projects may deliver significant benefits to Defence Materiel Acquisition and Management
- PPP identifies and allocates whole of life project costs ensuring transparency for Government and Defence
- Utilising PPP ensures Defence does not pay for a project until it is successfully delivered and meets Defence's accommodation or services standards
- PPP is the means by which further commercial discipline can be introduced into Defence Materiel Acquisition and Management
- ABN AMRO has proven capacity to deliver and a willingness to work with Government and Defence in developing PPP policy for Defence procurement