



New South Wales
Government

NSW Government
Green Paper

Working with Government

Private Financing of Infrastructure and Certain Government Services in NSW

November 2000



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**Private Financing of Infrastructure and
Certain Government Services in NSW**

A Public Discussion Paper

November 2000

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Foreword

Infrastructure makes the economy work—roads, rail, ports, power, gas. Other infrastructure, like schools and hospitals, holds our community together. NSW will remain economically competitive and socially cohesive only as long as our infrastructure is up to date, efficient and well sited.

My Government's infrastructure program over the next four years is worth a massive \$21.5 billion. Spending on capital works in the four years after the Olympics will be \$3.3 billion greater than the four years leading up to them.

Projects being funded include the Parramatta–Chatswood rail line, interurban rail upgrades, our \$36 million Rural Health Infrastructure Program, and the decade-long \$1.2 billion upgrade of the Pacific Highway, now in its fifth year.

There is no city–country divide, either. This year regions outside the Newcastle–Sydney–Wollongong corridor, with 27 percent of the State's population, will receive more than 35 percent of capital and road maintenance spending.

The NSW Government's infrastructure program is strong and credible. But resources are finite. Not all needs can be met, even with robust capital spending in a growth economy. True, priorities can be set, deferring some projects and discarding others. That is one choice.

Another option is for the public sector to work in partnership with the private sector to deliver projects that fuel growth and create jobs. That does **not** mean privatisation or outsourcing. Government policy on this is clear.

Instead, this discussion paper invites the community to look at models of collaboration that encourage private sector investment in public services while maintaining transparency, accountability and equity.

We've already seen from examples like the Olympic Village, Stadium Australia and the Superdome how private sector investment can secure important public benefits—in this case staging the most successful Olympics ever—at the same time relieving pressure on the public purse. We think that lesson may have a wider application, if handled responsibly.

The Government recognises there are many complex issues at stake, including social and philosophical ones. That is why we have chosen to have an open and transparent discussion.

The NSW economy is now in its tenth year of growth. Our unemployment rate is down to 5.5 percent, the best in Australia. Capital constraints will restrict further growth, and the proposals in this paper suggest paths forward. Let's debate the issues rationally and establish ways to ensure growth and prosperity will continue into the next decade.



Bob Carr
Premier

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Executive Summary

The NSW Government is reviewing its policy and guidelines on how the private sector can help to finance and supply facilities the government uses to provide some economic and social services.

This paper puts forward ideas to encourage debate about the most cost-effective ways of providing new facilities, how the private sector may get involved and how to improve interaction between the public and private spheres.

The paper does not revisit government policy decisions on the privatisation of existing government assets or contracting out of government services.

The private sector already works with the Government to provide electricity infrastructure, roads, light rail and other economic infrastructure. The Government is keen to consider whether the community could benefit from involving the private sector in financing, creating and managing some social infrastructure.

While the limits of private participation are a matter for discussion there are broad areas of government activity that will remain off-

limits to the private sector. For example, the Government does not see a role for the private sector in public health and education that goes beyond the supply and management of facilities and some associated support services. Clinical and nursing services in the public health system and teaching services in the public education system are not areas for private sector involvement.

This paper is intended to stimulate public discussion and comment as a contribution to the Government's policy review. The Government's policy priorities and service delivery plans form the broad framework for private participation. Proposals for private participation must be consistent with those priorities and plans.

To facilitate private participation, the Government proposes to:

- publish its agency's rolling asset acquisitions plans ten years ahead, wherever practicable
- establish a standing infrastructure services advisory council to advise the Government on opportunities for private participation.

Private sector participation can support the Government's fiscal strategy by improving value for money in government service provision and optimising risk allocation. Private financing does not relieve the budgetary and balance sheet constraints on government agencies.

The private sector must demonstrate that their packaging of design, construction, financing, operation and maintenance of certain types of facilities offers better value for money than a public sector delivery model. The public sector will have the potential to expand its services only to the extent that private sector delivery can provide a value for money gain.

Existing constraints on private participation are recognised. Some of these are institutional while others are embedded in the existing processes for government consideration of

proposals. The Government is working to relieve institutional constraints wherever possible, although most of them are beyond its direct control. A major focus of this paper and the review of the guidelines is process improvement. In addition to the publication of asset acquisition plans the Government proposes to:

- limit the number of bidders submitting detailed proposals
- consider compensation for reasonable bidding costs in certain specific circumstances
- nominate the Director-General of the Premier's Department as the initial point of contact for complex and multi-agency unsolicited proposals
- consider purchasing intellectual property rights for project designs.

Comments on these and other process improvements are strongly encouraged.

1 Introduction

This section argues for the timeliness of a discussion paper such as this, outlines the structure and limitations of the paper and provides the mechanisms and dates by which submissions should be made.

1.1 Why Have a Green Paper

The NSW Government has an enviable reputation for working with the private sector in the provision of public infrastructure—particularly in relation to road, rail and Olympic infrastructure.

The Government has provided clear directions in its publication *Guidelines for Private Sector Participation in the Provision of Public Infrastructure*. These guidelines are reviewed regularly and most recently updated in October 1997.

Since the last evaluation there has been considerable attention, both domestically and overseas, directed towards partnerships between the private and public sectors. A review is timely.

The continuing belief is that involvement of the private sector has the potential to:

- deliver improved public services and value for the taxpayer's dollar

- share risk while increasing flexibility.

The Government aims to maximise private investment in infrastructure to the extent that this results in better and more efficient delivery of existing public services.

The Government is always alert to better ways of providing public services and the infrastructure that supports them. The private sector has indicated that it has spare capacity and funds available for infrastructure development; it is willing to accept and share risk.

The purpose of *Working with Government* is to capture this opportunity to increase net benefits to the State and, at the same time, obtain comment on any issues or concerns held by the private sector that might impede this development.

Following consideration of submissions, the Government will review and refine its policy on private sector participation, identify the areas where this participation offers improved value for money, and determine how this may be assessed.

Through consistent application of this policy the Government will:

- maximise the net social and economic benefit to the people of NSW
- achieve an appropriate sharing of risk.

1.2 The Structure and Limits of Working with Government

Working with Government is designed to bring out the key issues that the Government needs to address in developing a new policy to engage the private sector. After reviewing the trends in infrastructure provision in NSW and the existing business environment and framework, three broad issues arise.

The most cost effective means of delivering infrastructure.

A broad discussion of the types of private sector involvement, its benefits, the issues that need to be considered and revenue sources. A series of questions are posed on the best way for the public and private sectors to operate together in the existing business environment.

The developing opportunities for the private sector.

Discussion on the Government's requirement, the types of infrastructure and the opportunities that exist. This section puts forward a number of questions to the private sector about proposals to meet the Government's requirements.

Improving the process for involving the private sector.

Discussion on the vexed issue of processes and how the Government's requirements for probity and responsible management of public monies can be matched with the innovative ideas and time imperatives of the private sector. Questions are asked about how the needs of both the public and private sectors can best be aligned and what improvements can be made to current processes.

Working with Government is aimed at engaging the private sector in the financing, creation and management of new infrastructure assets and certain related services. Opportunities are not limited to transport projects and the Government is keen to consider proposals in other sectors including health, education, housing, courts and their supporting administration, water and sewerage, energy, and waste and property management.

The scope of private sector involvement in the provision of public services is a matter for discussion and debate within the Government's existing policy parameters. For example, in public health services, the private sector could participate in some or all of the infrastructure and related services that support clinical services—but not the clinical or nursing services.

Working with Government is not a statement of policy, nor is it a detailed explanation of procedures and processes. Instead the paper is a catalyst—a means of seeking comments and ideas for how the private sector can better work with the NSW Government in the delivery of the services which have a major infrastructure or asset creation component.

The Government is keen to listen and obtain constructive comment.

Working with Government is not about privatisation of government businesses. It also goes beyond the limited scope of direct outsourcing of services, which tends to be purely operational and short term in nature.

The emphasis of *Working with Government* is on how private sector design, construction, financing, operation and maintenance can

deliver a better deal for tax payers once the Government has set its service delivery priorities.

1.3 Opportunities to Put Your Views Forward

The Government is keen to hear from any interested parties or members of the public. In particular the business and financial sectors, central and local government, community and voluntary organisations, trade unions, professional associations, academics, and consumer groups are strongly encouraged to bring forward their ideas and proposals.

Submissions are sought by 28 February 2001. They may be made in writing or by email or through the web site. Full contact details are located in Appendix 1.

2 Trends in NSW Infrastructure Provision

This section examines the meaning and need for infrastructure and details the NSW stock of infrastructure. Recent State infrastructure spending and the implications of infrastructure spending on fiscal strategy are discussed.

2.1 What Do We Mean by Infrastructure

Infrastructure relates to projects that are generally long lived and capital intensive, with few alternative uses once the investment is in place. Infrastructure projects are often seen as providing essential services. Infrastructure includes: the provision for water and sewerage facilities; surface water drainage; highways; transport facilities; energy distribution networks and telecommunications facilities; and schools, hospitals, social housing and other facilities to deliver services to the people of NSW.

In NSW a clear distinction is made between economic and social infrastructure. Economic infrastructure is generally funded by user charges or dedicated taxes and includes roads, railways, power generation and water supply. Social infrastructure is

normally funded from general revenue and includes schools, hospitals and police stations. It is important to establish this distinction because economic infrastructure has a cash revenue stream that can be used to finance investment.

The Government is open to consideration of private sector involvement in both economic and social infrastructure.

The provision of infrastructure in NSW is a shared responsibility between Government Budget Sector agencies, Public Trading Enterprises (PTEs) and local governments. Currently, the *Guidelines for Private Sector Participation in the Provision of Public Infrastructure* apply to all NSW Government departments and authorities (referred to as agencies). Local government is not bound by the guidelines but councils are encouraged to adopt similar requirements.

2.2 The Need for Infrastructure

Expressed in broad terms the Government's four key policy commitments are:

- realising the State's potential economic development and employment growth as a global centre

- achieving greater social justice for all members of the community and creating liveable cities
- integrating environmental protection into all activities
- delivering more financially responsible programs that reduce public debt and unfunded liabilities.

These principles in themselves generate considerable infrastructure demands. In addition, population growth increases demand for infrastructure. The 30 year projected population increase for NSW is 23 percent; from 6.2 million in 1996 to 7.6 million in 2026. The Greater Metropolitan Region's population is likely to grow from 4.6 million in 1996 to 5.7 million in 2026. While coastal regions will continue to have the fastest growth rates in the State, these rates should be slower than in the past.

Ageing infrastructure also needs to be replaced and updated. Recent improvements in efficiency and demand management by the major utilities sectors—electricity and water—have lowered the need for major investment in recent years, however, in the medium to longer term significant new investment will need to be undertaken.

Infrastructure investment in road and rail is also expected to need to keep pace with increased economic activity to meet industry demands. The net result is a significant demand for roads, transport systems, utilities, schools and hospitals—among others—and there are significant opportunities for private sector involvement.

2.3 NSW Stock of Infrastructure

Currently, NSW has a substantial and well-developed infrastructure base on which to build and allow the State to grow. Infrastructure and economic development are mutually dependent—economic development is enhanced by quality infrastructure and quality infrastructure is dependent upon a strong and growing economy.

It is estimated that the Government spends over \$2 billion annually on the maintenance of its infrastructure assets. In June 1999, the depreciated current value of State infrastructure related assets was around \$115 billion. The replacement value would be over \$400 billion. The general elements are shown in Table 2.1.

Table 2.1 Value of State Sector Infrastructure Related Assets, June 1999

Asset Types	General Government \$m	Public Trading \$m	Total State Sector \$m
Infrastructure Systems	28,902	27,749	56,651
Land and Buildings	30,729	19,522	50,251
Plant and Equipment	4,151	4,171	8,322
Total	63,782	51,442	115,224

Source: Consolidated Financial Statements of the NSW Total State Sector 1998–1999

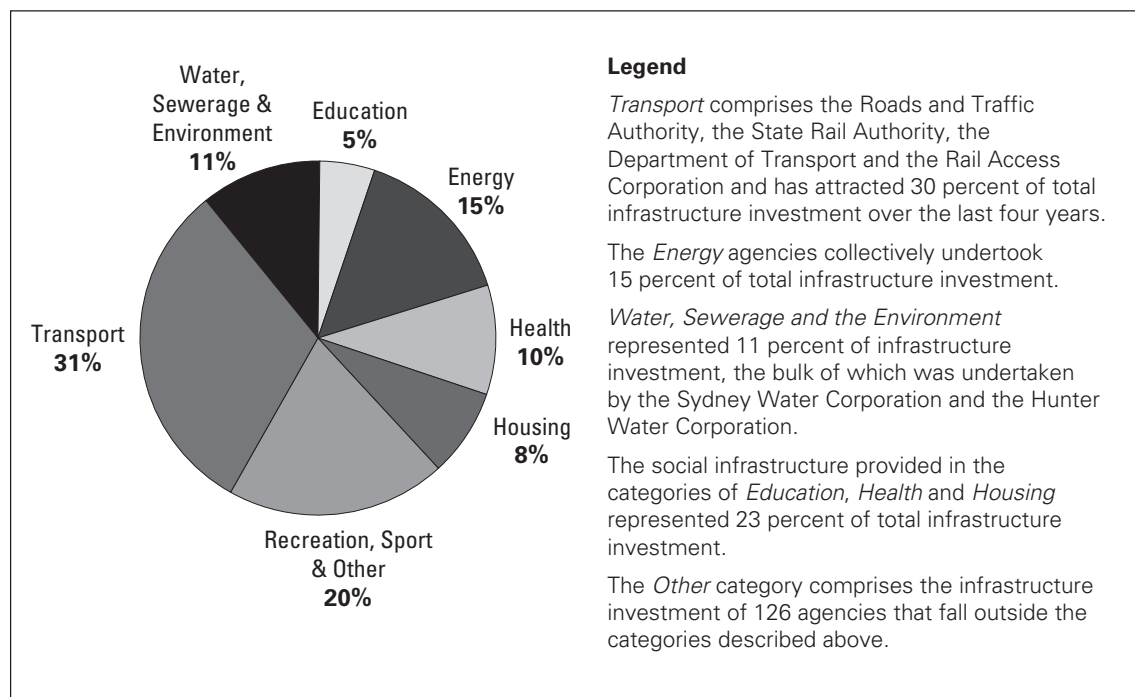
It is estimated that the Government spends over \$2 billion annually on the maintenance of its infrastructure assets.

2.4 NSW Government Infrastructure Spending

The State Asset Acquisition Program details the construction, acquisition and upgrading of the physical assets of the State. While the acquisition program includes expenses other than the creation of infrastructure assets, it provides a reasonable estimate of public investment in both economic and social infrastructure.

The allocation of total infrastructure spending in the four years from 1996/97 is depicted in Figure 2.1. In terms of real 1999/00 prices, the asset acquisition program funding increased 40 percent from 1996/7 to 1999/00 with a total of \$18.3 billion spent in the four year period (see Figure 2.1). A four year average has been chosen because it provides a general overview of the distribution of infrastructure investment. From year to year, however, infrastructure expenditure can be quite volatile because of large projects and one-off events, such as the Olympic Games.

Figure 2.1 State Asset Acquisition Program, 1996/97–1999/00



Looking at the current 2000/01 asset acquisition program budget, the distribution of infrastructure investment remains broadly consistent with the pattern over the last four years (see Table 2.2).

Despite the winding down of Olympics-related expenditure, the NSW Government plans to increase total asset expenditure in the four years beginning 2000/01, to \$21.5 billion; an increase of 18 percent on the preceding four years.

Table 2.2 NSW Government's State Asset Acquisition Program

Category	4 Year Average 1996/97–1999/00 (Real 1999/00 prices)		2000/01 Budget Nominal	
	\$m pa	%	\$m pa	%
Education	238	5	304	6
Energy	671	15	987	19
Health	445	10	472	9
Housing	370	8	430	8
Recreation, Sport & Other	935	20	825	16
Transport	1,436	31	1,677	32
Water, Sewerage & Environment	490	11	589	11
Total	4,586	100	5,284	100

Private Involvement So Far

The contribution of private sector funding to infrastructure provision in NSW over the last ten years has been about seven percent of the State's capital budget.

Private financing of public infrastructure is not new to NSW and the Government has effectively used a number of different schemes to deliver major public infrastructure. For example, under the Build, Own, Operate (BOO) or Build, Own, Operate, Transfer (BOOT) schemes, the private sector has delivered major physical assets and associated services worth an estimated \$5 billion over the last ten years.

From the Government's perspective, some projects have been more successful than others. However, the Government anticipates a higher level of success as it learns from its experience of dealing with the private sector.

Projects to date include:

Sydney Olympic Venues

- Stadium Australia
- Superdome
- Athletes' Village

Tollways

- Sydney Harbour Tunnel
- M4, M5, M2 and Eastern Distributor Road

Rail Transport

- New Southern Railway
- Pyrmont Light Rail
- Fourth Generation Trains

Health Related

- Port Macquarie Hospital
- Hawkesbury Hospital
- Hospital Car Parks

Water and Sewerage

- Prospect Water Treatment Plant
- Macarthur Water Treatment Plant
- Illawarra Water Treatment Plant
- Blue Mountains Sewerage Tunnel

Social Housing

- Public Equity Partnership Scheme
- Shared Equity Scheme

Other Projects

- Opera House car park
- Junee Prison complex

Property Developments

- Public Housing
- Woolloomooloo Wharf
- Walsh Bay Wharves
- Darling Harbour Wharves 9 and 10

2.5 NSW Fiscal Strategy—What it Means for Infrastructure

Infrastructure planning and provision takes place within the NSW Government's fiscal strategy framework. The framework is set by the General Government Debt Elimination Act, which specifies:

- a timetable for eliminating general government net debt, thereby securing the State's AAA credit rating. The medium-term target is to reduce general government sector net debt to a sustainable level by June 2005
- at least maintaining the Government sector's net worth in real terms from year to year
- Government spending and taxation restraint to maintain and strengthen the State's competitiveness and attraction to business investment.

Consistent with this strategy, budget surpluses have been achieved and net debt—and other financial liabilities—substantially reduced in recent years. At the same time, expenditure on infrastructure and other assets has been maintained at a high level.

The Government broadly intends to maintain the acquisition of infrastructure and other assets at a constant rate in real per capita terms, notwithstanding the completion of Olympic-related works. It will do so while continuing to achieve its fiscal strategy objectives. Nevertheless, the Government will consider alternative means

of service delivery that might displace the requirement for some infrastructure investment, where appropriate.

The private financing of infrastructure cannot generally be regarded as distinct from the State's fiscal strategy, or as a way of relaxing fiscal constraints. Privately financed infrastructure ultimately involves a budgetary cost, although in the PTE sector and in some other instances, user charges may negate the need for budget funding.

Even where the infrastructure assets do not appear on the general government balance sheet, the Government often bears contingent liabilities and unquantified residual risks associated with them. Projects, whether financed publicly or privately, must pass a rigorous economic appraisal process and be consistent with the Government's priorities and service delivery objectives.

Given the growth in demand for government services, the fiscal strategy places a premium on value for money in service delivery. This is the key to how private participation can support the fiscal strategy. The test for any project is whether better value for money can be achieved under private participation for both the development of new infrastructure assets and their ongoing operation and maintenance. The appropriate balance of risk is also critical to this consideration.

Where private financing creates a recurrent spending obligation for the Government, it must fit within the fiscal strategy. The benefits of private sector participation, such as earlier delivery and more efficient service, must be balanced against the ongoing commitment and inflexibility of such financial obligations.

Summary

- in this paper infrastructure relates to long lived, capital intensive projects currently with limited alternative uses once the investment is in place
- infrastructure is associated with the delivery of Government services and is important for the growth and development of NSW. There is a definite need for ongoing asset development and improvement
- the Government is open to consideration of private sector involvement in both economic and social infrastructure
- about 23 percent of the State's infrastructure expenditure is on social infrastructure in areas such as health, education and housing
- the Government plans to increase the total asset expenditure program for the next four years
- NSW is in a very strong economic situation with a sound fiscal strategy
- private sector financing proposals must fit within the Government's fiscal strategy
- there is considerable scope and opportunity to engage the private sector in the development of public infrastructure
- over the past ten years the private sector's participation in infrastructure provision has averaged seven percent of the State's capital budget. There is scope for that figure to rise

3 The Business Environment and Framework

This section outlines the institutional constraints faced by the private sector and the Government in developing infrastructure financing arrangements. The Government's position is also presented.

There are a number of strong influences on the way the Government does business.

These include:

- taxation
- accounting standards
- the capital market
- probity and accountability
- revenue sources
- other legislation and regulation.

Some legislation is enacted by the Commonwealth and is outside the direct control of the State. However, both sectors—government and private—must operate within this environment in the provision of public infrastructure and services, and the limitations and restrictions of this environment need to be well understood.

3.1 Commonwealth Taxation

Many observers see tax reform as essential if partnerships between the private and public

sectors are to achieve their full potential. Concerns about the taxation system have not been satisfied by the partial implementation of the Federal Government's Ralph Report and this interim stage contributes to the amount of uncertainty.

An infrastructure project consortium will incur significant early income tax losses as interest accrues on the debt prior to the project generating assessable income. Post construction, however, the consortium will have a number of allowable non-cash deductions which can be deducted from its assessable income. These include depreciation, building and development allowances and business expenses.

Section 51AD and Division 16D of the *Income Tax Assessment Act, 1936* deal with infrastructure and its funding. Both provisions can adversely impact on project financing, although this depends on the extent to which the Government is deemed to have assumed commercial risk and control. Section 51AD is a challenging section. If applied, the private sector is denied all the tax benefits associated with asset ownership. Basically, this section

applies where a state or local government—as a tax exempt entity—is deemed to effectively control the use of the asset and its output.

Division 16D covers non-leverage leases which could be used by a tax exempt entity for providing the assets. The effect of this Division is to treat leases and similar arrangements as loans. The owner of the plant or equipment is thereby prevented from obtaining depreciation and other ownership benefits.

The Public Infrastructure Unit of the Australian Taxation Office (ATO) specialises in infrastructure projects. It is possible to obtain a non-binding, fast-track ruling for infrastructure projects from this unit when there is some concern about whether Section 51AD or Division 16D apply to the proposed project. A non-binding ruling can normally be obtained in four weeks. The ATO can be approached for a private, binding ruling when the project is confirmed.

The NSW Government requires a non-binding ruling on Section 51AD compliance before approval is given for a project to proceed to preferred proponent stage. This ruling can be obtained from a taxation expert or the ATO. Final contracts will, however, be subject to a condition precedent that requires a binding ruling from the ATO.

NSW Treasury is working with a Commonwealth Government taskforce reviewing the detailed aspects of the leasing

provision associated with the Ralph proposals. The Ralph Review has recommended the abolition of Section 51AD and the modification of Division 16D.

3.2 Government Contributions and Tax Treatment

How government contributions are treated for tax purposes is also a significant consideration. Invariably government is involved in some way in infrastructure projects. It may own the land, it may own or control inputs to the project and is typically the user of the outputs. In some cases, government may contribute to financing a project.

If the Government does contribute financially, considerable care needs to be taken, particularly for cash contributions. The principal concern here is that a cash injection may be treated as assessable income to the project vehicle. It could also be considered as a bounty or subsidy or merely income according to ordinary concepts, and fully taxable upon receipt.

Where the funds are made available in the form of a loan, a normal interest-bearing loan structure is required. Commonwealth tax would be incurred where a contribution is assessed as income. In this case, the tax would have to be paid by the developer and the State Government would not achieve full value for its cash contribution. The Ralph Review recommends that government cash grants to projects be considered non taxable.

Government contribution to road projects usually takes the form of land provision at a relatively nominal rental. Where government owns the land, the government entity could be obliged to improve it before the private sector project commences. Typically this improvement would involve clearing and demolition work, which has little scope for tax relief for the private sector. Under this arrangement the Government takes ownership of a part of the asset. The private sector is unable to claim any tax deductions on that part of the asset provided by government.

In projects to date, the Government has:

- provided subordinated loans to the project company
- undertaken leasehold improvements to the land
- provided capital grants where the tax risk is borne by the private sector.

3.3 Accounting Issues

Accounting issues are another significant consideration. Most contractual arrangements with the private sector for the provision of public infrastructure are highly complex in their financial construction. This complexity reflects the need for each sector to achieve its individual objectives with an appropriate degree of protection.

Issues have arisen over the accounting treatment for BOOT arrangements because a recognised Australian accounting standard capable of covering the transactions does

not exist. The issues have concerned the ownership of the infrastructure, the existence of a lease, and deeds of charge over infrastructure held by the State.

In projects to date the Government's position has been to:

- recognise the contribution of land to a BOOT arrangement as an operating lease
- treat the infrastructure constructed on the land as a leasehold improvement, which is to transfer to the Government at the cessation of the land operating lease term
- recognise the Government's right to future ownership of the infrastructure on an emerging basis.

The Government's proposed approach is very similar to that adopted by the UK Accounting Standards Board, which analyses the risks associated with service delivery and the accounts are drawn and based on the party bearing the majority of the risk. Agreement to this approach throughout Australia is yet to be achieved.

The primary objective of involving the private sector in financing of infrastructure should not be driven by balance sheet considerations. Delivering capital projects that do not appear on the Government's balance sheet is financially beneficial to the State. However, service delivery, value for money and optimal balance of risk are the driving forces.

Projects in which capital raising is considered a liability on the Government's balance sheet could still proceed, but only if the delivery agency is able to bear the capital cost within its budget.

3.4 Capital Market Issues

The availability of private capital for public infrastructure projects has provided a major impetus to private sector involvement in the provision of public services.

Changes in the financial system have affected capital markets over the last 20 years. The globalisation of capital markets has been associated with the creation of a large pool of funds and the development of sophisticated risk management techniques. This has two implications for infrastructure investment. Firstly, both public and private sectors have ready access to large quantities of long-term debt. Secondly, the growing maturity of capital markets has removed many of the constraints that previously restricted private sector involvement in infrastructure investment.

Although significant changes have occurred in Australia's financial system in the last 20 years, the Australian finance market for infrastructure projects remains limited. Investment in public infrastructure has to compete with other domestic and offshore investment options for which capital markets have developed sophisticated analytical tools. Infrastructure projects tend to be an unfamiliar type of investment and analysts lack the skills and benchmarks to evaluate them.

There is a need to distinguish between available equity and available debt when discussing the capacity of markets to fund projects. In the right conditions, with the right assets there is abundant equity capital available internationally, for example the Victorian electricity utility sales to foreign investors.

Debt markets are, however, limited in tenor due mainly to the fact that most fund managers cannot invest in fixed income over 10 years. The Commonwealth Government's longest dated offering is an eleven-year security. There remains a lack of cost effective or value for money long term 25–30 year project risk based bond issues needed to support long term infrastructure projects. Structured CPI bond issues are possible but can be expensive.

Analysts estimate that the Australian market could absorb \$4 billion of debt offerings per annum depending on the nature and attractiveness of the underlying assets. This amount will increase over time given the underlying growth in funds under management and the decline in Commonwealth and State Government borrowings.

Superannuation funds represent a substantial and growing pool of national savings. However, to date direct investment by superannuation funds in infrastructure has been limited. Investment in infrastructure could be suitable and even desirable for superannuation funds. Given the long term nature of superannuation

investments, a long term investment vehicle should be of interest to fund trustees. The movement of superannuation savings into infrastructure would be accelerated by the public listing of infrastructure securities, such as has occurred for the M2 Motorway. Analysts have suggested that infrastructure proponents need to describe and present their assets so they can fit with the fiduciary duties of the trustees.

3.5 Probity and Accountability

Privately financed projects are significant to the State in terms of long term financial liabilities. Contracts for these projects are usually lengthy—up to 30 years. Consequently, in its dealings with the private sector, the Government needs to maintain a high level of accountability.

Probity is an important issue for the Government as custodian of the community's assets. By adopting a clear probity process, all parties are assured that the Government is spending money wisely to achieve outcomes which satisfy community needs. The Government ensures the appointment of a probity adviser to verify the integrity of the awarding process; all parties must comply with the process and decisions must be made on fair and objective grounds.

The Government requires the publication of a contract summary for privately financed projects with a capital value of more than \$5m. The summary, which is first vetted by the Auditor-General, must be

tabled in Parliament within 90 days of the contract becoming effective.

To maximise community and business confidence in its tendering practices, the Government has established independent review mechanisms for complaints about tendering with government agencies. The State Contract Control Board is responsible for issues associated with probity, National Competition Policy and the Australian and New Zealand Government procurement agreement. The Independent Commission Against Corruption (ICAC) is available to examine complaints about potentially corrupt conduct in the procurement process.

The NSW Government has a good reputation as a business partner because its dealings have been conducted with efficiency, fairness, impartiality and integrity. Business trust and confidence is enhanced through transparent and consistent practice and decision making in the NSW public sector, together with clearly defined standards of behaviour required of organisations seeking to do business with government.

The NSW Government's Code of Practice for the Construction Industry and the attendant Code of Tendering define the ethical principles and standards of behaviour for all parties involved in the provision of public infrastructure. This includes projects which involve private sector financing. The Codes apply to all procurement actions; application

commences when a business decision is taken to approach the market for a tender response and concludes at project completion. In this way the Codes provide signposts to government agencies and industry participants at all levels of the contract chain about what the NSW Government requires in areas such as tendering, project and contract planning and management and cooperative relationship management.

3.6 Revenue Sources

Revenue sources are a vital component of any financial package. They are fundamental to the viability of the project and can dictate the tax assessment and treatment.

Income related to privately financed projects could come from many sources but would generally fall into three distinct categories:

- charges to third party users, through direct customer payments
- direct government payments for delivery of services
- property developer levies from land value increases.

The Government has adopted a market risk approach to the delivery of privately financed projects with the private sector being empowered to charge tolls for the use of a road, a station access fee for rail projects, or a parking fee for car parks. Prices have been set to fully recover the cost of building and financing the projects.

In projects where the Government has been the purchaser of the service, it has used a number of methods to determine the service charge. Charging arrangements have generally consisted of an availability charge and a usage charge. The availability charge relates directly to the financing costs of the project, while the usage component relates to the ongoing cost of delivering the service. Availability charges have been structured so that payment occurs regardless of service performance. The Audit Office has likened availability charges to finance leases and requires them to be reported as debt items.

Government policy for the provision of social infrastructure requires the payment of a single charge on delivery of a specified service. This payment is closely measured against performance-based outcomes. Payment methods used overseas include: shadow tolls, where the road operator is paid from consolidated revenue according to the volume of traffic; and shadow fares, where the rail or public transport operator is paid from consolidated revenue according to the number of passengers using the service.

Section 51AD and Division 16D of the Income Tax Assessment Act are deterrents to the pursuit of shadow tolls and fares because the State could be deemed to control the use and output of the asset or to have provided a loan to the private sector operator. This would preclude tax benefits for that operator. Additionally, it is not clear if sufficient risk could be transferred through the performance contracts to

remove debt raising from the Government's balance sheet.

Land value capture is often put forward as a means of revenue capture to support a project. It involves an infrastructure provider capturing or seizing part of the windfall gains in land value, which is conferred by a particular infrastructure project. Land value capture is not a new concept and is widely used overseas, particularly in the USA where local governments commonly apply impact or developer fees. The concept has more recently been adopted in NSW by the application of specific development charges to fund specified local government infrastructure.

Accurately measuring any relative change in property values attributed to a specific project, is difficult. Defining a benefit area could also create problems, especially when dealing with properties in the vicinity of the boundaries. Introducing a property development tax could disadvantage one area over another development area which was not subject to the tax. These issues may preclude land value mechanisms being introduced.

3.7 Other Legislation and Regulation

A great deal of legislation affects the financing of public services. Three important areas impacting on private sector involvement are: the Public Authorities (Financial Arrangements) Act; the National Competition Policy and associated

Independent Pricing and Regulatory Tribunal; and the Loans Council.

3.7.1 Public Authorities (Financial Arrangements) Act

Under the *Public Authorities (Financial Arrangements) Act*, 1987 (the PAFA Act), the Treasurer has responsibility for approving agencies entering into 'joint financing arrangements' as defined in section 5A of the PAFA Act. Terms and conditions of contracts must be negotiated between sponsoring agencies and Treasury so that it can advise the Treasurer about joint financing obligations.

3.7.2 National Competition Policy and IPART

The National Competition Policy (NCP) is well established and supported by all governments in Australia as a means of achieving effective competition. A key component of the policy is the concept of competitive neutrality for government businesses, which eliminates any competitive advantage that might result from public ownership. The acceptance of the policy has resulted in the restructuring of public sector monopoly businesses to allow third party access to nationally significant infrastructure and the extension of price surveillance to state and territory businesses.

The Independent Pricing and Regulatory Tribunal (IPART) plays an important role in the pricing of government monopoly services. The tribunal agrees annual maximum price determinations for

electricity, gas, water supply and related services as well as government urban passenger transport. IPART pays specific attention to consumer protection, economic efficiency, financial stability and environmental and other standards.

The setting of prices for government services directly influences revenue streams and the commercial viability of infrastructure and related service projects. The importance of equity and community service obligations (CSOs) are recognised in the NCP. Governments are free to transparently subsidise important community services for appropriate groups, such as aged pensioners.

3.7.3 Loan Council Treatment

In the past, Loan Council treatment has significantly influenced the ability to raise funds for infrastructure projects; recent changes have lessened its impact.

State borrowing in Australia is determined in the context of a Federal system. The Commonwealth, through the Loan Council, has substantial control over the borrowing of the general government sector and to a lesser extent the public trading

enterprise sector. A second constraint is the self imposed fiscal restraint implemented in *the General Government Debt Elimination Act, 1995*.

Treatment of BOOT arrangements has been the subject of lengthy debate in the Loan Council. Until 1993, BOOT projects were either counted as a borrowing or outside the global limits. Until 1993, the global limits approach resulted in private sector parties designing elaborate financing arrangements to keep an arrangement outside the Loan Council criteria. This resulted in inefficient and costly finance plans.

In 1996, the Loan Council revised the assessment of private sector infrastructure projects from the previous risk-weighted approach to the Government's full contingent exposure based on termination conditions in the contract. The Loan Council also agreed in principle that these exposures would be reported as a footnote to a jurisdiction's Loan Council Allocation and not counted as a borrowing. As a result, the Loan Council has ceased to be a major determinant of whether a project should or should not proceed.

Summary

- infrastructure and related services projects involving the private and public sectors, operate within a complex regulatory framework
- Commonwealth tax and the treatment of State Government contributions to a project need to be closely considered because of the potential impact of adverse rulings
- financial appraisals of projects are complicated by the lack of a recognised Australian Accounting Standard
- Capital Market participants suggest there are funds readily available for public infrastructure investment. Public infrastructure is, however, only one of many assets in the global market and the availability of the funds has not been fully tested
- the Government has a very clear responsibility to the people of NSW that dictates a very strict probity and accountability process
- although the business environment is challenging, it provides opportunities for the mutual benefit of both sectors

4 Private Involvement—Forms and Benefits

This section lists the various types of private sector involvement in providing public services. The significant benefits are discussed as well as the counter issues that need to be considered when assessing the relative merits of projects and proposals.

4.1 Types of Private Sector Involvement

It is widely accepted at all levels of government in Australia that the private sector should be involved in providing public infrastructure. This shift has generated a wide array of arrangements with differing levels of innovation and flexibility including:

- BOO and BOOT
- long term service provision contracts
- joint ventures
- barter arrangements
- government office space leases (precommitted leases).

Brief descriptions of each type of arrangement can be found in Appendix 2. Selecting the most appropriate arrangement for an infrastructure project is a critical

decision. It depends on the scale of the project, its complexity and the opportunity for risk transfer.

Full public sector provision of infrastructure is now a rare occurrence. Even when the public sector dominates an infrastructure project, there is still room for private sector involvement. This usually takes the form of inputs—such as materials—or construction debt finance from private sector financial institutions.

At the other end of the spectrum—full private provision or privatisation—the private sector provides infrastructure subject only to government regulation. Under privatisation, a government may still purchase activities, such as Community Service Obligations (CSOs). Lower charges for pensioners receiving gas from a private utility is an example of a CSO.

BOOT projects sit in the middle of the spectrum and are sometimes mistaken for contracting out. At the margin there is little distinction between the two categories. Contracting out is characterised by:

- high operating component and low capital component

- most of the service payment risk is born by the Government (no third party revenues)
- a high government contribution through recurrent payments
- a short concession period of up to ten years.

4.2 International and Other Experience

Public–private partnerships commenced in the late 1970s when economic policy in the United States and Europe, for example, shifted in favour of competitive market forces. Initial partnership models were simple and generally involved the delivery of specialist services with defined resource requirements and little technical innovation.

During the 1980s, attention was drawn to the impact of the private sector on public sector performance. Initially this facilitated conventional outsourcing models with defined operational requirements, buyer seller relationships, and some innovation in design. By late in the decade, private sector financing was considered the most promising avenue to explore for infrastructure development funding. This was particularly evident in Europe where the use of private financing initiatives and operating franchises increased markedly.

A significant shift in the focus of partnership arrangements came in the late 1990s. Best value regimes, emphasising active engagement with service users, direct

comparison with best practice and direct responsibility for continuing improvement, were adopted in some countries with greater involvement in public services, such as defence, transport, justice, education and health. In some areas there has been a shift towards alliances with alternative forms of market testing and contracting.

In the UK, the Government has entered into contracts for toll roads, rail projects, hospitals, schools, prisons and defence-related facilities. The toll road projects operate where the toll is a shadow price paid by the Government; the road user does not pay the toll. The Government has also contracted for light rail projects involving the construction, operation and maintenance of passenger services for a period of 25 to 30 years. The private sector proponent has the right to retain fare revenue.

Hospital projects have been undertaken in the UK where new buildings and their ongoing maintenance have been provided, but not clinical services. Contracts have also been awarded for the building and support of schools, but not for teaching and related services.

In North America, private financing has concentrated on toll roads and private prison facilities. The focus in South East Asia has been mainly economic infrastructure of toll roads, power stations and railway projects. New Zealand has generally elected for either full public provision, or privatisation, and has only

entered into one major BOOT project; a toll road.

Toll roads, water treatment plants, public transport services and prisons have been undertaken in other Australian states. An examination of the experience outside NSW shows that there is not a universal model and that the evolution of different models is quite rapid. To varying degrees, all countries have different constitutions, layers of governments, accounting standards and legislation. These differences lead to the adoption of models that best suit the individual requirements of that state or country. Even within a state, one model does not fit all types of projects with the private sector.

The UK Experience

Private sector investment in public infrastructure services has been particularly successful in the UK, especially in defence, health, education, transport and justice.

The UK Government is not only engaging the private sector to provide asset-based infrastructure, but is undertaking long-term purchasing arrangements with a guarantee that these services will be provided to satisfactory standards.

Since 1997, the UK Government has signed contracts worth an estimated £14 billion with the private sector. Contracts worth £20 billion are to be considered in the next two years.

It is estimated that the private sector will contribute about 14 percent of the overall investment in public infrastructure. Growth in this contribution is anticipated.

4.3 Benefits of Private Investment

From a government perspective the primary aim of any private sector involvement in the provision of public services is the best value for money. Additional advantages offered by the private sector's involvement are risk transfer, innovation and flexibility.

4.3.1 Value For Money

The concept of value for money contains a number of different aspects, particularly when dealing with privately financed public infrastructure. Value for money should include meeting the Government's economic, social development and environmental policy objectives; it does not automatically mean the lowest price.

In assessing value for money, the differences between economic and social infrastructure need to be considered. Off balance sheet arrangements are likely in the case of economic infrastructure where the private sector company interacts directly with the public through the payment of tolls, fares and other charges.

Where there are no third party payers in a scheme, the Government will have to pay the full cost of the project over time. For the project to be viable, efficiency savings from private sector delivery must be sufficient to cover the extra cost of private sector financing. These savings could arise from changes and innovation in the delivery of services.

True value for money needs to compare the end costs of service delivery options that

include all costs associated with government administration and the provision of services. It needs to fully consider the whole of life costs of the various options that include, where appropriate, the rectification of possible maintenance backlogs. The costs of risk acceptance also need to be evaluated as well as the possible potential value of delivering a service at an earlier date. The determination of value for money is a very complex equation. The benchmark cost comparison discussed in Section 4.4.1 is central to this process.

The achievement of value for money relies heavily on the expertise of public sector employees being able to specify the outputs required and to negotiate effectively. The level of services needs to be specified in sufficient detail to ensure that the bids received are comparable but still allow scope to maximise innovation.

Competition in the bidding process is an important element in achieving value for money. However, the maintenance of competition in the bidding process may be difficult to achieve because the costs of bidding for BOOT projects by private firms are considerable and, at the end of the process, firms may not wish to commit more resources without some assurance of success.

The private sector have the potential to produce efficiencies by:

- being innovative in design, construction, maintenance and operation over the life of the contract

- creating greater efficiencies and synergies between design and operation
- investing in the quality of the asset to improve long-term maintenance and operating costs
- managing risk, in some areas, better than the public sector.

The long term value for money of these arrangements will depend on how well the private sector manages the risks that have been transferred and how well the public sector manages the contracts over their duration. The UK Government has reported that their privately financed projects are, on average, delivering savings of 17 percent over traditional forms of service delivery. Savings range from 10 percent for prisons to 20 percent for defence projects. Savings of similar magnitudes may present a challenge in NSW because of the large amount of competitive outsourcing already undertaken by government agencies.

4.3.2 Sharing Risk

A strong argument in favour of involving the private sector is the opportunity to share risk. The NSW Government will accept those risks it is best able to control and manage and transfers risk where it can be shown that there are net benefits to government and the community. The Government should not assume operational risk that effectively underwrites the viability of the project. The types of risk vary a great deal from project to project and are complex in their nature. They can include

the risk of cost and time in the design and construction phases as well as commissioning, management and maintenance risks. Transport network, traffic flow and patronage risks are very important to most transport projects. The risk of residual value, including advances in technology that could render an asset obsolete, also need to be taken into account. Regulation, tax and planning risks have to be considered, as do the risks associated with project financing.

In recent projects, the private sector has demonstrated a willingness to share risks that can be identified and priced. The Government seeks to optimise the balance between public value for money and risk transfer. Achieving this goal presents a considerable challenge. There is a need for openness and transparency in the negotiations and an unambiguous understanding of who is accepting what risk. Commercially unrealistic risk allocation is not in the best interests of the Government or the private sector.

The Government acknowledges the risk being taken by the private sector in any proposal and the cost associated with this risk. Accepting risk has a cost and the cost has to be met. This applies equally to both sectors and if it is decided that government is best placed to carry a risk, it should be reflected in the price the Government pays for the service. Notwithstanding the sharing of risk, government has a responsibility to the community to maintain the delivery of services. There is a residual risk relating to

the delivery of services that government can never transfer to the private sector.

4.3.3 Innovation

Innovation is a commonly cited benefit of private financing arrangements. Removing constraints on the public sector has the potential to encourage innovation to deliver greater value. The potential also exists to deliver value for money when compared to normal government delivery if design, construction and operation are integrated.

The introduction of infrastructure in the financial markets has enabled the development of innovative financial instruments that could improve the viability of projects. However, innovative financing arrangements may lead to significant transaction costs in arranging project finance. A concern for government would be that any innovative finance instruments not be considered surrogate to 'State Debt'.

The need to encourage innovation in privately financed projects places further pressure on government departments and agencies who should specify the required outcomes in clear and accurate terms; inputs, such as detailed technical requirements, are not necessary.

4.3.4 Timely Provision/Flexibility

Privately financed projects can eliminate up-front capital costs to government and allow government to confidently commit to the long-term cashflows associated with the required service outputs. In addition, the

private sector may have more flexibility in raising funds because it is not bound by the constraints of the government budget cycle.

The private sector is strongly motivated to deliver the project on or before time to reduce overall construction costs and to commence generating revenue. This can lead to the accelerated delivery of the infrastructure and potential benefits to the State from advanced service delivery.

4.4 Issues to Consider

The above discussion has highlighted some of the benefits of private sector financing and emphasises the importance of evaluating value for money. The following sections identify some of the major issues that need to be considered by government in assessing the relative merits of proposals and the potential benefits of private involvement.

4.4.1 Public Sector Benchmark

The essence of private sector financing arrangements is that in addition to buying an asset, the public sector is purchasing the long-term provision of a service of a guaranteed quality. They do this in the knowledge that penalties exist, in the form of reduced payments or compensation, if the service is not provided at the right time or to a satisfactory standard. Finance costs are, therefore, only one element of the value for money calculation.

In reaching a judgement about whether a privately financed contract will offer value

for money and, therefore, whether to proceed, the Government compares the contract with an assessment of the cost of alternative public sector financing and management.

A benchmark cost comparison is provided to the Budget Committee at the progressive stages of project approval. In establishing the benchmark cost comparison a competitively neutral financial model is developed to represent the Government delivery option. In establishing the benchmark model the following factors are taken into account:

- delivery as if a government-owned corporation
- an appropriate debt and equity structure
- a guarantee fee levied on the Government's cost of debt
- application of a tax equivalent regime
- a risk adjusted return on equity reflecting the inherent risk of the project's ongoing operations.

4.4.2 Cost of Public Versus Private Finance

That the public sector can generally raise debt at a lower cost than the private sector is an indication of the public sector's superficially lower cost of capital. This would suggest that private financing of infrastructure is relatively inefficient and that the economic benefits would be maximised by public financing. However, to ensure efficient use of resources, the same

cost of capital should be used for both sectors for assets of the same risk characteristics when investment decisions are made about public sector projects.

If public sector projects are required to earn a lower return than comparative projects in the private sector, capital is applied inefficiently in the economy. This results in suboptimal investments and produces a lower social yield. Thus a public sector project must produce a yield which returns:

- the risk free rate
- the risk premium dependent on the systematic risk of the project with the risk premium determined from private sector opportunity costs of capital.

In evaluating the risk of an asset an important principle is that the cost of capital is independent of the source of financing. Consequently it is erroneous to conclude that financing of an asset from either public or private sources will change the cost of capital which attaches to the asset.

The characteristics of a project undertaken by the private sector may differ from a similar project undertaken by the public sector because of explicit or implicit guarantees that attach to the asset. In, for example, the construction of an inner city building, because the characteristics of the asset will be different, the expected return will be different to correspond with the different risk and return expectancies of the asset.

Risk sharing between government and the private sector generally results in a lower risk to the private sector than if there was no government involvement because it is invariably more efficient for government to assume some systematic risks in the project. This effectively changes the characteristics of the asset and changes risk to the private sector participant. The appropriate cost of capital to the private sector should then be lower because the characteristics of the asset have changed in response to the assumption of some risks by the public sector. It does not occur because government can borrow at a lower rate than the private sector.

If the pricing of government contracts for provision of infrastructure is calculated and negotiated using the full private sector cost of capital for similar projects, without taking into account the risk reduction resulting from government involvement, the discount rate will be too high. In this situation the private sector parties will receive an economic rent for risk they do not bear and government will pay an excess cost for the risk assumed by the private sector.

4.4.3 Sharing Super Profits

Sharing of super profits is a separate issue. Opponents of BOOT-type projects are concerned that if a project turns out to be more profitable than expected and revenues are higher than forecast, the private sector operator gets most of the reward. Community perceptions that the private

sector is receiving super profits could adversely influence worthwhile private sector infrastructure projects.

The Government is conscious of the need to maintain a balance between government and private operators equitably sharing in any profits which result from faster than anticipated revenue growth. To date, the Government's policy has been to profit share above a capped return on equity figure. In most contracts this provision is not expected to be triggered until near the end of the project period if the revenue forecasts follow the contractual financial model.

4.4.4 Transactions Costs of Private Involvement

The transaction costs involved in arranging finance for BOOT projects are likely to be greater than for similar publicly financed projects. The transaction costs associated with BOOT projects stem, in part, from the preparation and finalisation of contracts. Substantial time and resources are consumed in negotiating risk allocation and other intricacies in the contractual arrangements.

Other transaction costs are incurred by the private sector because of its need to conduct its own feasibility and market demand studies. Government also incurs a cost through the assessment of the private proposals.

Current procedures work on the principle that there should be professional, fair, equitable and open interplay between

government and the private sector ensuring that probity is maintained and tendering costs are minimised.

With the experience gained in these arrangements there would appear to be merit in developing a consistent contractual approach to handling certain components of risk sharing within portfolios. Costs to both sectors could be reduced.

4.4.5 Intellectual Property

Validity of intellectual property rights is a key issue for both unsolicited bids that require market testing and bids that may warrant direct negotiation. Mechanisms for identifying the validity of intellectual property are limited.

In addressing this issue it is important to:

- identify the intellectual property aspects of preliminary proposals
- manage intellectual property issues during preliminary discussions
- develop a competitive tendering process which fully protects intellectual property if direct negotiations are not approved
- identify those key phases of a project that are open to market testing, to ensure the Government achieves value for money without compromising intellectual property rights.

The Government aims to work closely with proponents to achieve greater certainty in its treatment of intellectual property.

Summary

- there are many forms of suitable involvement for the private sector in the provision of government services and related infrastructure
- there is a wide variance in the international experience of the private sector providing public services. There is no single model that suits all circumstances and projects should be examined on a case-by-case basis
- value for money is the principal advantage of private sector engagement
- the private sector can offer value for money in the provision of public services and related infrastructure through its:
 - ability to share and manage appropriate risk
 - innovation
 - efficiencies and synergies between design and construction
- the Government has to assess true value for money by comparing private sector proposals with a properly costed public sector benchmark and consideration of relative funding costs, transaction costs and sharing of profits
- the cost of public financing of a project should take account of the risks specific to the project. On this basis the public sector's financing cost advantage is not as large as sometimes thought
- there would appear to be merit in developing a consistent contractual approach to handling certain components of risk sharing within portfolios. Costs to both sectors could be reduced

Issues for Discussion

The Government is keen to receive feedback about the best way to maximise the benefits of working with the private sector. In particular it is interested in:

- the lessons that can be learnt from the experience gained to date both in Australia and overseas
- how value for money and risk transfer can be optimised
- what improvements might be incorporated into the public sector benchmark to enhance competitive neutrality
- what are the advantages and disadvantages of making the public sector benchmark available to private bidders
- how transaction costs can be reduced
- how a proponent's intellectual property might be better protected in a competitive tendering process

5 Development Opportunities For the Private Sector

This section outlines the focus of private sector involvement to date and examines opportunities and services suitable for future private sector involvement. In addition, two closely related issues of significance to the future development of the State—the ongoing development of rural and regional NSW and the information and communications technology sector—are examined and presented as opportunities for the private sector.

The Government is keen to extend the current paradigm for engaging the private sector wherever it is practicable. It would like to broaden the range of service sectors for private involvement and looks to the private sector to develop proposals for viable packages within new areas.

The Government aims to maximise private investment in infrastructure to the extent that this results in net benefits to the community beyond those from public provision and leads to a better and more efficient delivery of public services.

5.1 Focus to Date

Major projects to date have principally followed the BOOT model. There has been a predominant transport focus and a tendency towards single projects as opposed to integrated networks. A major consideration has been an attempt to remove the asset and associated borrowings from the balance sheets of government agencies. Another driver has been the endeavour to minimise public risk.

Characteristics of projects have been:

- a reasonably narrow project focus
- pursuit of ‘no net cost to government’
- aiming to maximise risk transfer and minimise government exposure
- predominantly user pays with some CSO contributions
- limited government input—usually corridor acquisition
- generally inflexible contracts with the potential to become adversarial.

5.2 What the Government is Looking For

The Government wishes to investigate greater involvement for the private sector in areas such as: energy and water utilities; health; education; housing; waste management and green industries; and courts and their supporting administration. It is also looking to expand the private sector's involvement in information and communications technology and in rural and regional NSW.

The Government's aim is to maximise the net benefit to the State in terms of effective delivery of quality services and value for taxpayers dollars with an appropriate balance of risk. This benefit should be calculated on a whole of life basis that includes construction and ongoing operations and management costs.

Understandably, the private sector is looking for projects that are supported by a sound business case and provide a reasonable commercial return. Commercial viability on its own, however, will not satisfy the Government's needs. Projects need to be enhanced by private involvement and must accord with the Government's priorities to demonstrate net benefit.

Experience gained over recent years should benefit the current process evolution.

Involvement with the private sector should now be aimed at increasing the public value for money and balancing the risk so that it is carried where it is best able to be managed. Off balance sheet financing may

or may not be the by-product of these arrangements, but it is not the objective. If private sector participation does result in improved value for money, public sector liabilities will be lower than under a purely public sector service delivery model.

The characteristics of future projects should exhibit:

- a broader range of social and economic infrastructure projects
- priorities set by community needs
- economic viability, including all externalities used to assess relative merits
- private and public sectors share costs that are determined on the basis of defined outcomes
- a sharing of risk with an appropriate risk transfer
- more flexible contracts that reflect a genuine partnership to provide quality community services in the most cost effective way.

There are a wide variety of models available for the private sector to work with government. Indeed this is one of the areas where innovation is apparent. With the opportunities available it is of paramount importance to match the right project with the right method of delivery.

5.3 Opportunities That Exist

In virtually all public asset development projects, the Government wishes to test whether a commercial element would provide better value for money. This is

relevant to large transport projects as well as smaller projects in other sectors that when packaged together form a commercially viable grouping that produces a net benefit for the State. These packages could include all, or some, of the services associated with creating and managing public assets.

Engaging the private sector in the provision of government services presents an exciting opportunity for government agencies to clearly consider and articulate the service outcomes required. The process then provides government with the opportunity to buy these outcomes from the private sector to produce the best value for money and optimal transfer of risk. Contracts struck should clearly specify key performance indicators and agree on a means of measurement to determine the level of payment.

There is a great deal of flexibility in the scope of projects deemed suitable by the Government for private sector participation.

5.3.1 Transport

Transport encompasses all public transport infrastructure. The sector provides a very fertile area for private sector engagement and this is unlikely to change. The Government will invest \$1.68 billion in roads and transport in 2000/01; there are more than \$5 billion worth of RTA major projects in progress.

The integrated transport plan, *Action for Transport 2010*, sets out the Government's policies and plans for developing the

transport system in NSW. Within the plan there are substantial opportunities; some projects are suitable for private financing and all have an element of private sector involvement. Very large projects, such as the Cross City Tunnel and the Lane Cove Tunnel, are at an advanced stage of development and approval. They appear to have a significant potential commercial component.

Action for Transport 2010 also presents network development opportunities, such as the Rapid Bus Transitway in Western Sydney. In the future there may be opportunities to bundle transport projects with broader urban development into a single financing package.

5.3.2 Utilities

The NSW Government remains opposed to the privatisation of energy and water utilities. However, there are opportunities for private sector participation in these sectors.

Sydney Water has a \$2.2 billion capital expenditure program over the next five years as part of its *Waterplan 21* strategy. The corporation is looking to garner benefits from the private sector in the forms of technical expertise, innovation and cost effectiveness while optimising the opportunity to share risk.

Government-owned electricity corporations will invest around \$988 million in 2000/01. The NSW transmission service provider, TransGrid has a five year capital works

program worth almost \$1.1 billion. The TransGrid publication, *a NSW Annual Planning Statement 2000*, guides investment decisions and contributes to the optimal development of electricity transmission in the State. This document undertakes an assessment of main network capabilities and potential constraints, including a list of specific network constraints and options for their removal. TransGrid will be seeking private sector involvement in the provision of related services, technical expertise and innovation.

5.3.3 Health

The Government intends to invest about \$1.2 billion in capital projects to support public health services over the next five years. A significant number of large programs are being proposed within the context of the services driven Area Health Service Asset Strategic Plans. The health sector offers many opportunities for the private sector but they do not include the delivery of clinical services for the public health system. They do, however, include the creation of assets and their ongoing operation and management. In recent years, private sector funded infrastructure has been primarily limited to hospital car parks.

The Government would like to expand the level of private involvement to include all types of public health assets and to all types of commercial and not for profit entities. For example, the private sector may build a hospital and maintain it and the surrounding property. Subject to current

government procedures and constraints on outsourcing, this could include providing catering, security and other support services. It could even provide and manage the information technology support and possibly the medical equipment.

The private sector could package such an array of services and provide them for a concession period of say 20–30 years. During that period the private sector would be paid by the Government to provide the set of non-clinical services that had been contracted and provide them to a clearly stated performance standard.

For the concession period, the Government would retain ownership of the land providing it to the project as part of an operating lease. The infrastructure constructed on the land would be a leasehold improvement, owned by the project for the period of the lease and concession and handed back to the Government on completion.

5.3.4 Education

The Government has recognised the importance of continuity between secondary and tertiary educational services by amalgamating education and training into a single agency, the Department of Education and Training. The Department serves 760,000 school students and 450–500,000 TAFE students. It has an annual capital budget of around \$300 million. However, most individual projects are limited in size. Its current three year program involves construction of 26 new schools and 50 upgrades.

The private sector could build new schools as well as renovate and upgrade existing schools. It could even provide, maintain and upgrade, as appropriate, the information and communications technologies and associated support. Security, maintenance and the management of the physical assets are options for private sector engagement. Similar to health the opportunities in education do not extend to the provision of teaching and associated administrative services in the public system.

The Department of Education and Training sees some potential for the private sector in the bundling of projects in new release areas, such as the north-west sector of Sydney. The Department is keen to test whether such arrangements can improve the timeliness of the delivery and upgrading of schools and provide an improved integrated service over the life of the school, particularly in areas such as grounds and building maintenance, security and cleaning.

5.3.5 Justice

The total major works program for 2000/01 for police, corrective services and the courts is around \$160 million.

Certain police stations, such as Bondi and Merrylands in Sydney, occupy valuable real estate that could be further developed to provide commercial opportunities while still providing the facilities necessary for the Police.

The building and ongoing maintenance and operation of courts, plus certain administrative services to support the courts, such as IT, present further prospects for greater private sector involvement.

5.3.6 Housing

The Government will invest over \$420 million in 2000/01 to provide new and improved existing social housing. The public housing sector, with assets valued at \$16 billion offers considerable opportunities for private sector investment in:

- redevelopment or reconfiguration of the existing asset base
- provision of new social housing either on an owned or leased basis and their ongoing management.

The Department of Housing has previously been to the market for innovative schemes for private sector investment in social and affordable housing. The Department would like to expand upon the opportunities in this area and include partnerships with the not for profit sector.

5.3.7 Waste Management and Environmental Services

Waste management is an area where the Government has demonstrated national leadership by legislating a comprehensive waste minimisation and management framework. This initiative has prompted innovation by the private sector to minimise landfill and exploit waste's potential as a resource. Clusters of green industries are developing around recycling

and processing. This, and the emerging environmental service markets encompassing carbon sequestration, salinity remediation and biodiversity restoration, are areas offering opportunities for private sector involvement and where private sector innovation could produce positive environmental and economic outcomes.

5.4 Economic Development Opportunities

Although not technically within the mould of private sector participation—the primary focus of this paper—there are two areas that are very significant to the future development of the State and, therefore, warrant discussion and presentation as opportunities for the private sector. They are the ongoing development of rural and regional NSW and the information and communications technology sector.

5.4.1 Rural and Regional NSW

Increased private sector involvement in the growth and development of rural and regional NSW is actively sought. Projects in this sector of the State are typically small, possibly without a critical mass, and with a greater balance of social and environmental benefits as opposed to a commercial return. Many projects linger between economic and financial viability and do not proceed. Innovative ideas to bring a number of the projects together, either within a geographical area or a business sector, to achieve commercial viability would be of great benefit to the State.

Regional services are being upgraded and present opportunities for the private sector. Projects that incorporate and develop local businesses are strongly encouraged.

5.4.2 Information and Communications Technology

The further development of information and communications technology is of great importance to the State to support economic development and firmly establish NSW as a regional service hub in the Asia Pacific area. The ICT industry is renowned for its growth and the many opportunities it provides.

The ICT companies attracted to NSW require large complexes with supporting services. They benefit from being clumped together and affiliated with universities, TAFEs and other learning institutions. They require a skilled workforce and a quality of life that attracts the industry and its workers. NSW can meet all of these needs and the private sector could assist in packaging and presenting the necessary requirements.

Besides the ICT companies themselves, there is the broader application of the services they provide in generating business opportunities and efficiencies in operations throughout the State. These require ICT infrastructure, that again generate private sector opportunities.

The Government is committed to making NSW the 'Connected State' by accelerating

ICT services to the community and delivering diversification into regional NSW to bridge the digital divide. Particular opportunities exist to provide ICT infrastructure into urban release areas, which incorporate new residential developments, business parks and industrial estates.

The Government is interested in investigating initiatives that can improve telecommunications access and bandwidth that may involve coordinated arrangements with Government agencies. This paper, however, is not being used to canvas ideas or proposals on the outsourcing of Government ICT services on their own or in clustered arrangements. ICT proposals that are part of a package of private infrastructure investment will only be considered.

Summary

- the Government wishes to extend the involvement of the private sector in the provision of public services and related infrastructure to encompass social infrastructure
- the Government aims to maximise the net benefit to the State, in terms of effective delivery of quality services and value for taxpayers dollars, with an appropriate balance of risk
- lessons can be drawn from recent experience to produce a more balanced arrangement for the mutual benefit of both sectors
- there is a great deal of flexibility in the scope of projects deemed suitable by the Government for private sector involvement
- there would appear to be many opportunities available for the private sector

Issues for Discussion

Government is keen to receive feedback from the private sector about proposals that might meet the Government's requirements. In particular, the Government is interested in:

- how private sector involvement might be widened to new or additional service sectors and areas
- any actions, within the Government's control, that can be taken to encourage further private sector participation within existing or in new sectors and areas

6 Process Improvement

This section examines current and possible future planning frameworks, the approval process and its costs, and the need for greater understanding and information sharing between the public and private sectors, particularly in relation to financial modelling.

The Government is aware of some of the concerns raised about the current guidelines. Specifically, these centre on the clarity of the Government's requirement and the need to streamline identification of potential projects for private sector involvement and the associated approval process. The importance of a clearly defined process and its consistent application is also acknowledged. An integral part of this process is the need for accountability, transparency and equity.

6.1 Planning Framework

Responsibility for infrastructure planning and provision rests with individual State agencies; the Budget Committee of Cabinet approves projects. Agencies are required to maintain capital investment strategic plans (CISPs) that provide detailed development plans for the first five years and a broad outline for the following five years.

CISPs are a component of each agency's asset strategy, which also include strategic plans for asset maintenance and asset disposal. Together, these plans provide a whole-of-life picture of construction, ownership and maintenance of public infrastructure. They reflect the Government's broader policies and priorities.

Cross agency coordination and a very long term focus present a challenge to infrastructure development. To address this issue, an Infrastructure Coordination Unit has been established within the Premier's Department. The Unit's prime responsibilities are to provide and facilitate infrastructure coordination across the State and provide advice to Government on significant infrastructure projects and issues.

Both the private and public sectors could benefit if future plans, based on the CISP from each agency, were consolidated and made public. Better knowledge of the Government's requirement and identification of commercial opportunities would assist the private sector in targeting its resources and generating proposals.

Clearly there is a degree of uncertainty in any long term plan and it would remain subject to changes in the prevailing circumstances and priorities. An appropriate format would need to be developed and the utility of long term plans in areas such as health and education, which are heavily influenced by shorter term services demands, will need to be tested. Nevertheless, the intention would be to indicate, as far as is practicable, the estimated value and scope of major infrastructure projects and their expected year for Budget consideration. An indication would also be provided of which projects the Government considered suitable for private sector involvement.

6.2 The Project Approval Process

Several stages of decision making are required to determine whether the benefits to the community have been identified and maximised, and that probity and accountability requirements have been met. In addition, separate environmental and planning approvals have to be obtained.

Competitive bidding is central to the process and can only be circumvented in exceptional circumstances with the approval of the Budget Committee of Cabinet. The basic five stage process for Budget approval is summarised in Table 6.1 and described in detail in Appendix 3.

Table 6.1 Project Approval

Stage	Phase	Actions
1	Project Definition	<ul style="list-style-type: none"> • Strategic Planning • Initial Project Development – <i>Budget Committee Approval</i>
2	Proposals and Short Listing	<ul style="list-style-type: none"> • Call for Proposals • Evaluation and Shortlisting – <i>Budget Committee Approval</i>
3	Detailed Proposals and Assessment	<ul style="list-style-type: none"> • Call for Detailed Proposals • Evaluation and Recommendation – <i>Budget Committee Approval</i>
4	Negotiations and Contracts	<ul style="list-style-type: none"> • Negotiations with Preferred Proponent • Contractual Agreement – <i>Budget Committee Approval if significant variations arise in negotiations</i>
5	Disclosure and Implementation	<ul style="list-style-type: none"> • Issue Contract Summary • Implement Project • Post Implementation Review

6.3 Cost of Submitting Proposals

The Government intends to make projects more cost effective by minimising the cost of bidding for BOOT projects for both the public and private sectors. This would include better scoping for project definition, affordability and bankability. In addition, it is proposed that only a small number of bidders be subject to detailed submissions.

If the Government is bearing the full cost of the service delivery—through a performance based payment—there may be situations where it may wish to acquire the property rights to the project design before final bid prices are received. This would enable the Government to obtain the most cost effective and efficient solution and value for money. In these cases, the Government would reimburse the design and development costs but would own the property rights to the project designs.

Under normal circumstances tender cost will not be reimbursed. However, when a decision is taken not to proceed with a project and that decision is not related to the viability of tenders received, some form of compensation for contractor's bidding costs would be negotiated.

6.4 Unbundling the Financial Models

The Auditor-General has criticised the length of concession periods and other financial aspects of some toll road projects. In this regard the Government is vulnerable if it does not have full and open access to

the financial models that lie behind bids made by the private sector.

It is necessary for the public sector to fully understand the private sector's funding package. There is a need to analyse cost inputs, including those that are part of the financing package. Financing costs represent a significant proportion of the total costs of a typical BOOT project. A full understanding of the margins being charged are necessary to understanding the value for money drivers and project affordability.

It is proposed that for future BOOT projects the detailed tender bid will include the financial model that was used to price the tender. The Government will use the models to assess the cost of operations, maintenance, and other operational support that are a necessary part of the public sector benchmark. Reviews will be undertaken of the construction costs and the level of risk transfer reflected in the model.

6.5 Environmental Planning Requirements

The Government is committed to all public projects meeting the obligations of the *Environmental Planning and Assessment Act, 1979* (EP&A Act). The Act balances social and economic development in the State with environment protection through land use planning procedures, development control processes and an environmental impact assessment framework.

These obligations have implications for the way in which the Government seeks to

establish value for money benchmarks through the competitive tendering process, in particular, the stage at which the private sector should become involved in the project approval process.

Experience has shown that there is no ideal time to secure the planning approval for privately owned and funded public infrastructure. If government wishes to encourage the greatest level of private sector design and construction innovation, the environmental approval phase should occur after detailed bids have been received. This leaves the price of the final project uncertain because final development approval conditions will be required before final price and contract negotiations can commence.

Additionally, if an agency has negotiated a nearly complete solution with a private consortium, costly variations may have to be negotiated if the planning approval imposes unexpected requirements. This places the onus on the agency to establish value for money by means other than competitive market pressure.

The most appropriate timing of private sector involvement in the project approval will vary from project to project. In this respect a standard approach may not be effective. The Government is keen to seek private sector views on this issue.

6.6 The Important Role of Agencies

Government agencies are responsible for delivering the State's infrastructure.

Within a framework of broad government policies and priorities, agencies develop strategies and plans that generate infrastructure proposals. Agencies have prime responsibility in the project definition phase, the evaluation and shortlisting of proposals, and in preparation of the final evaluation and proposal for the Budget Committee of Cabinet. Agencies also have a very important role in obtaining planning approvals and ensuring projects satisfy environmental protection regulations.

The agencies provide the interface between the public and the private sectors and it is to the mutual benefit of both sectors to engage early and fully in the development of proposals for private sector participation. In close collaboration with Treasury and the Premier's Department, the agencies will determine which projects are suitable for private sector participation.

In pursuit of the best net benefit for the State, agencies need to develop or have ready access to the skills and expertise that are necessary to assess the benefits, and contract the private sector. In the UK this need has led to the establishment of private financing units in some government agencies. There is a clear need to build skills and understanding in both sectors while working together closely. The UK experience indicates this is most important in opening up social infrastructure opportunities.

6.7 Unsolicited Proposals

Government welcomes unsolicited proposals. They can provide a source of innovation in how government services might be better delivered. As with all projects, they need to demonstrate an overall benefit to the community and be consistent with the Government's plans and priorities. Commercial viability alone will not be sufficient to gain government support.

The Government will generally test unsolicited proposals in the market place through competitive tendering to maximise both financial efficiencies and effective delivery of services.

Some unsolicited proposals seek direct negotiations between the Government and the proponent. Such decisions have to be approved by the Budget Committee of Cabinet and will only be considered when the proponent can demonstrate that the intellectual property of the proposal is of such significance and benefit to the public interest that competitive tendering is not warranted.

Proposals that are clearly designed to support a single agency should be considered by that agency. A proposal that has a cross agency element, or is a new initiative that is not currently part of the Government's plans or priorities, needs wider consideration.

There is clear advantage in identifying a single point of contact to capture the opportunities presented and provide timely

and comprehensive feedback to the proponent.

The Government, in its new policy, is intending to use the position of Director-General of the Premier's Department as the initial point of inquiry and use the resources of the Department to coordinate a whole-of-government response.

6.8 A Partnership Perspective

In the era of globalisation, innovative ideas quickly spread internationally and through large multi-national organisations. Such ideas include better ways to provide government services and public assets and benefit from international experience. Some governments are endeavouring to capture these ideas through advisory councils and closer interaction with the private sector.

An option for the Government is to instigate an infrastructure services advisory council. The council's role would be broader than the private sector's involvement in infrastructure development. It could provide high level advice on how the private sector can best assist the Government in providing quality services. The Council would have no executive or approval authority, but its advice could inform policy development and it could provide formal feedback to the Government on its policy and development priorities. A council of about 20 representatives of a cross section of major industries and government is envisaged. It would meet about twice a year.

Summary

- a clear, transparent process for involving the private sector in the provision of public infrastructure and its consistent application is very important to both the private sector and the Government
- as part of the planning framework, the Government proposes to publish the forward capital investment plans of its agencies in a rolling ten year program
- a maximum of four bidders will submit detailed proposals
- the Government will consider purchasing property rights for project design
- financial models used to price a tender are proposed as an inclusion in detailed tender bids
- in certain specific circumstances the Government will consider compensation for reasonable bidding costs
- the Government intends nominating the Director-General of the Premier's Department as the initial point of contact for complex and multi-agency unsolicited proposals
- the Government is keen to work closely with the private sector to enhance mutual benefits

Issues for Discussion

The Government is keen to receive feedback about what improvements could be made to processes for private sector participation in the provision of public infrastructure. In particular, the Government is interested in:

- the level of support for the development of a public long term plan of public capital investment
- suggestions to minimise the cost of tendering and submitting proposals
- possible issues for the private sector in providing details of the financial model used to price the tender
- proposals for better managing the Environmental Planning and Assessment process
- support for the proposed means of handling Unsolicited Proposals and possible alternatives
- support for a form of infrastructure services advisory council and suggested inclusions for its roles and functions

7 Conclusion

NSW is a prosperous State. It is in a strong economic position with a substantial and well developed infrastructure and service base. The provision of high quality services is of paramount importance to the Government so that it may encourage further economic development, community building and environmental enhancement. Development of the infrastructure to support these objectives commands a very high priority.

Notwithstanding this sound position, there is no room for complacency. To maintain the levels of service experienced by the people of NSW, the Government has to search for efficiencies and more effective means of provision. The need for the ongoing development and upgrading of the State's infrastructure is always present. So is the need for testing alternative and more effective and efficient ways of providing government services.

For many years the private sector has been involved in the provision of public

infrastructure. NSW has been innovative in engaging the private sector in areas such as transport, water supply and the Olympic Games. From this experience, much has been learnt in both sectors. Opportunities and processes are evolving from experience gained in Australia and overseas.

The private sector has indicated a willingness to take up the challenge to share the risks and bring its innovation and best practice to provide the necessary assets in the most cost effective manner and maximise the net social benefit to the State. The Government welcomes this opportunity to broaden the relationship with the private sector. It is timely to review government policy and guidelines so that potential benefits for both sectors can be maximised.

This discussion paper provides all interested parties with the chance to express their views to the Government and for them to be taken into account in formulating a new policy. All are strongly encouraged to contribute.

Appendix 1

How You Can Play a Part in This Process

Those wishing to make a submission should send their comments using one of the following:

By post to:

Working with Government Task Force*
NSW Government
Level 37, Governor Macquarie Tower
1 Farrer Place
Sydney NSW 2000

By fax to:

(02) 9228 4004

By email to:

greenpaper@premiers.nsw.gov.au

Submissions close on 28 February 2001.

Copies of the Green Paper can be viewed and downloaded at the *Working with Government* website: www.nsw.gov.au/wwg

At the close of submissions, the Government will consider convening workshops to investigate more thoroughly key issues raised. Your interest in attending such a workshop should be noted in your submission. Should the workshops proceed, times, venues and registration forms will be posted on the Taskforce web site. For more information telephone (02) 9228 5049.

*The *Working with Government* Task Force is comprised of representatives of the Premier's Department, The Cabinet Office, Treasury and the Department of Public Works.

Appendix 2

Description of Private Sector Arrangements

Buy-Build-Operate

The transfer of an existing public facility to a private partner which renovates or expands the facility. It is then entitled to own and operate the facility in perpetuity.

Build-Own-Operate

An option for privately financing a project in which the private entrepreneurs agree to build a public facility at their own expense in return for the right to operate the facility and charge users a government-regulated fee.

Build-Own-Operate-Transfer (BOOT)

An option for privately financing a construction project in which the private entrepreneurs agree to build a public facility at their own expense in return for the right to operate the facility and charge users a government-regulated fee. At the end of a contractually-determined period, ownership of the facility reverts to the State.

Build-Transfer-Operate (BTO)

A private developer finances and builds a facility and, upon completion, transfers legal ownership to the sponsoring government agency. The Government

leases the facility back to the private developer under a long term lease during which the developer operates the facility and has the opportunity to recover its investment and a reasonable profit through user fees and commercial enterprises.

Joint Venture

A form of agreement between any number of parties, including the private and public sectors, in relation to a project with the aim of producing mutually agreeable results. Joint ventures constitute a form of partnership but not necessarily one of a continuing nature.

Lease-Develop-Operate

An arrangement whereby a private developer is provided with a long term lease which permits the developer to both operate and expand the facility whilst simultaneously investing in the extensions and improvements and recovering a return for such investment.

Alliance Contracts

Public and private partners of an alliance are jointly responsible for project results and work in an integrated team to achieve

agreed cost, time and quality targets. The alliance provides incentives to encourage and reward outstanding performance. There are strong financial penalties if the cost, time or quality targets are not achieved. The agreement provides a no-dispute culture, prohibiting litigation except for wilful default. This avoids the adversarial approach associated with traditional contracts.

Barter Arrangements

Barter arrangements typically occur when government disposes of assets in return for facilities or infrastructure of equivalent value. The payment may be made as a combination of cash and an exchange of titles to the assets.

Government Office Space Leases

Reducing the Government's exposure to increasing office accommodation costs is a key objective. Government leases for office space is a useful mechanism in providing short- to medium-term needs. Such leases also provide the Government with flexibility in dealing with office accommodation requirements.

Long-term Service Provision Contracts

A mechanism whereby government secures a contract with the private sector for the long-term provision of services at a fixed rate. Long-term service provision contracts help ensure that costs are always kept in check or contained so that high quality services are provided and financial risk is avoided.

Appendix 3

The Budget Approval Process

This appendix provides a description of the existing Budget approval process for capital projects with private sector participation. Separate environmental and planning approvals also need to be considered and obtained.

To enable the Cabinet Committee to be fully briefed on proposals, the economic impacts, financing plans, risk management plans, statements of fiscal impacts, statements of accounting treatment and Loan Council assessments relating to proposed projects need to be analysed.

The critical decision points of the approval process are:

1. Cabinet Committee approval to proceed to market testing and shortlisting
2. Cabinet Committee approval to call for detailed proposals
3. Cabinet Committee approval to finalise negotiations with the preferred proponent.

Agencies should contact Treasury as early as possible to discuss the proposal and central agency requirements, and to agree to a timetable for providing information.

Agencies will be expected to liaise with Treasury throughout the process.

Agencies should note that for projects under \$5 million, authority is delegated to the Treasurer to approve requests for calls for proposals from the private sector and enter final negotiations with a preferred proponent. Agencies should also discuss simplifying the approvals process with the Treasurer for small projects where the risk profile is well understood; that is, based on previous experience.

Each proposal to be considered by a Cabinet Committee should be presented by the responsible Minister as a Cabinet Minute. This should be formally submitted to the Premier, as Chairman of the Cabinet Committee. Proposals to be considered by the Treasurer should be presented by the responsible Minister in a form agreed during discussions between the agency and the Treasurer.

1. Call For Proposals and Shortlisting

Before being authorised to proceed to call for proposals, agencies will need to undertake and submit the following:

- agency's asset strategic plan

- an economic appraisal report, which would include analysis of alternative options
- an economic development impact statement in (see attached pro forma PSI-1)
- analysis of public sector delivery option
- financial feasibility report
- risk management plan
- statement of fiscal impacts.
- assessment of economic development impacts
- financial analysis report
- evaluation of public sector delivery option
- risk management plan
- statement of fiscal impacts
- statement of accounting treatment
- preliminary tax ruling
- Loan Council assessment
- relevant material advised by Treasury.

Agencies should ensure that the above are progressively supplied to Treasury to enable sufficient time for advice to be prepared for the Cabinet Committee, but no later than 20 working days before the scheduled Committee meeting.

2. Call for Detailed Proposals

Following Cabinet Committee approval to proceed, agencies will arrange evaluation of private sector proposals. Before any request for approval to call for detailed proposals from shortlisted proponents, agencies will need to provide updated information to Treasury, at least 15 working days before the scheduled Cabinet Committee meeting.

3. Negotiations

Before the Cabinet Committee authorises an agency to finalise negotiations with a preferred proponent, the agency should provide Treasury with the following documents related to the project.

- detailed project description
- assessment of environmental development impacts
- updated economic appraisal

These should arrive at least 15 working days before the scheduled Committee meeting.

4. PAFA Approval

Under the *Public Authorities (Financial Arrangements) Act 1987*, the Treasurer is responsible for approving agencies entering into joint financing arrangements.

The sponsoring agency should agree to the terms and conditions for contract negotiations with Treasury to enable it to advise the Treasurer about the joint financing obligations. The terms and conditions agreement should set down the scope of the project and areas for final negotiations, as well as providing the conditions under which the Government would support the project. A draft terms and conditions for negotiation agreement should be jointly prepared by the agency and Treasury prior to the Cabinet Committee's approval to enter into negotiations with the preferred proponent.

The Cabinet Committee will need to consider and approve any significant variations which arise during negotiations before contracts are finalised.

Appendix 4

Abbreviations

AAS	Australian Accounting Standard	HWC	Hunter Water Corporation
ASP	Asset Strategic Plan	ICAC	Independent Commission Against Corruption
ATO	Australian Tax Office	ICT	Information and Communications Technology
BBO	Buy, Build, Operate	ICU	Infrastructure Coordination Unit
BOOT	Build, Own, Operate, Transfer	IPART	Independent Pricing and Regulatory Tribunal
BOT	Build, Operate, Transfer	LCA	Loan Council Allocation
BTO	Build, Transfer, Operate	LDO	Lease Develop Operate
CISP	Capital Investment Strategic Plan	M4	Motorway 4
CSO	Community Service Obligation	NCP	National Competition Policy
DET	Department of Education and Training	PAFA	Public Authorities (Financial Arrangements) Act, 1987
DoH	Department of Health	PSC	Public Sector Comparator
DSRD	Department of State and Regional Development	PTE	Public Trading Enterprise
EPAC	Economic and Planning Advisory Commission	RAC	Rail Access Corporation
EP&A	Environmental Planning and Assessment Act, 1979	RTA	Roads and Traffic Authority
FOI	Freedom of Information Act	SRA	State Rail Authority
GDP	Gross Domestic Product	SSD	Sydney Statistical Division
GMR	Greater Metropolitan Region	SWC	Sydney Water Corporation
GSP	Gross State Product	TAFE	Technical and Further Education

Appendix 5

Glossary

Asset A general term referring to a range of resources which represent some value. Assets can be categorised into: financial, such as cash, stocks and bonds; and real, such as land, buildings, machinery and inventory. For accounting purposes, intangible assets, such as patents, goodwill and trademarks, have the potential to provide future benefit to the organisation by their use or sale.

Bond A bond is an interest-bearing certificate of debt, issued by borrowers, such as governments, State authorities, companies or any person who issues the document in return for cash from lenders and investors. It is a formal promise by the borrower to pay the lender a certain sum of money (a principle amount) on a fixed future date, with or without security. The borrower pays interest to the lender. Bonds are generally medium- to long-term fixed interest securities and redemptions. The bondholder is a creditor, unlike the shareholder who is an owner.

Budget Sector Agencies Public Sector entities which provide, in the main, goods and services outside the market mechanism as well as providing for the transfer of

income for public policy purposes. In NSW, most Government departments fit into this category.

Capital A generic term for an asset. Capital sometimes refers to financial investments, and at other times refers to physical capital, such as land and buildings, earthworks, machinery and vehicles.

Capital Expenditure An amount used during a particular period to acquire or improve long-term assets, such as property, plant or equipment.

Consolidated Fund An account for revenue received by government and payments of departments and certain authorities within the budget sector. Payments out of this fund can only be made under Parliamentary authority.

Community Service Obligation (CSO)

A payment by Government, from the Consolidated Fund, to Public Trading Enterprises to undertake non-commercial activities.

Debt An obligation by one individual or company to pay a specific amount of money to another party.

Debt Finance Broadly, the concept is used to describe borrowing where the funds provided to finance business are provided by borrowings of all sorts from numerous sources. Debt finance refers to the use of loans by companies to finance their operations, particularly capital expenditure through long-term loans. The overall cost of capital may be reduced by the use of debt.

Demand Management The use of pricing mechanisms or other methods to manage demand e.g. to obviate or delay the need for new infrastructure.

Digital Divide The gap between the level of information and services available to people who possess the necessary skills and resources to regularly access the internet compared to those without.

Equity Owner's equity is the amount by which the assets of a business or organisation exceed the liabilities of that business or organisation. It is the residual interest in the assets of the entity after deduction of its liabilities, shared by one or a number of equity holders.

Exposure A term used to refer to one's vulnerability to the potential variations in interest and exchange rates. The term assumes that there is an element of risk involved. Nervousness about such vulnerability has spawned markets which offer methods of protection, such as: hedging through futures trading or forward markets; borrowing in floating rate facilities; and taking multicurrency loans.

Financial Risk Risk associated with the mix of debt and equity used to finance a business or property. The larger the proportion of debt used, the greater the financial risk. A firm or business with no debt financing has no financial risk. Financial risk can also refer to the risk associated with a firm's source of finance or when an individual or business buys many types of debt or equity instruments. A financial risk exists if the company issuing the instruments incurs financial hardship and is unable to pay the sum the investor had expected.

Fund A reserve of money or investments held for a specific purpose, such as to provide a pension or pay off a debt. It can be used to denote capital assets, liquid assets, money in hand or notes and bills.

Government Debt Debt incurred by government bodies—State and local government—brought about through spending on capital improvements, such as schools, highways and hospitals.

Greater Metropolitan Region (GMR) The area comprising the Sydney region—including the Central Coast—the Newcastle region and the Wollongong region.

Infrastructure Fixed assets which support economic and social development in a fundamental way. The prefix 'infra' connotes something which underlies or underpins other structures. Typical examples of infrastructure are networks or roads and telecommunications facilities,

airports, ports, water storage distribution and sewerage, railways, electric power generation and distribution facilities.

Intellectual Property A company's patentable ideas, including business ideas, concepts and theories.

Liability In general terms, liability refers to the debt of an individual or of a private or governmental organisation. Liability is the opposite of an asset.

Loan Council A body with Federal and State representation which aims to constrain the public sector's call on national savings, primarily through the limits it places on borrowing by the public organisations.

Loan Council Allocation (LCA) The LCA is the borrowing allocation to be nominated to Loan Council by the Commonwealth, States and Territories. It is based on the deficit/surplus in addition to some memo items. Final negotiations and endorsement of each LCA are the responsibility of the Loan Council.

Market or Demand Risk The risk which confronts any new business where revenue from a project will be insufficient to ensure an adequate return. Forecasting aids in the evaluation of return on investment, however, forecasting does not guarantee that certain revenue will result from the project. An unavoidable risk associated with market demand, remains.

Operation and Maintenance Contract An agreement in which a private partner operates a publicly-owned facility under contract with the sponsoring government.

Outsourcing The practice of contracting out Government services to the private sector.

Private Finance Initiative (PFI) PFIs were initiated to promote cooperation and partnership between the public and private sectors for the development of major capital works projects.

Physical Infrastructure Reasonably synonymous with economic infrastructure (defined above). It includes those elements of infrastructure which support industry by providing transport, communication, energy and other facilities to firms and individuals.

Public Trading Enterprises Non-financial authorities which provide services and products in the market and generally operate on a commercial or quasi-commercial basis, such as government owned corporations.

Recurrent Expenditure Expenditure of an ongoing nature that is other than capital expenditure.

Revolving Loan Fund The establishment of a fund which has as its objective the support and development of continuing programs of infrastructure projects. Funds for this are established from Federal-aid

loan repayments or State funds. By concentrating on projects of a similar nature, revolving funds have the benefit of diversifying elements of risk, making them attractive investment opportunities.

Risk Sharing Risk is shared between parties involved in a venture when more than one party will enjoy the benefits of a desired outcome. The willingness to take on a share of the risk is usually identified with ownership of an equity share in an enterprise. It goes without saying that an equity partner will not generally agree to take a share of the risk unless they stand to enjoy a share in the profitability, given desired outcomes.

Shadow Toll A notional toll, set by agreement between government and the private sector operator of an infrastructure facility. The government agrees to pay the operator the shadow toll for every vehicle that uses the facility. In other words, it is government that pays the toll to the operator, not the users of the facility.

Social Infrastructure Although loosely used, this term generally refers to items of physical infrastructure, which aid the provision of social—rather than economic or industrial—services. Hospitals, schools,

police stations, day care centres and prisons are examples of this type of infrastructure.

Statutory Corporation A corporation authorised by a special Act of Parliament, for example, a nationalised corporation. It is a body set up by government under its own charter to provide particular goods and services. It is also known as a statutory authority and is different from any other corporations because it is State owned. The State Bank and the Water Boards are statutory authorities.

Tax Risk A project is said to be subject to tax risk when the Tax Office considers that the transaction does not involve sufficient risk for the private sector. As a consequence, the Tax Office denies the private sector tax deductions for the project. Avoidance of such risk can be obtained from the inclusion of tax determinations within contracts.

Value Capture This term is used to refer to the concept of an infrastructure provider capturing or seizing part of the land value, which is conferred by the infrastructure project. For example, government may capture the value of an infrastructure project by redirecting revenues from that project to other developments.

Appendix 6

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NSW Government
Green Paper

**Working with
Government**

Private Financing of
Infrastructure and
Certain Government
Services in NSW

November 2000