

4.4 PUBLIC PRIVATE PARTNERSHIPS

INTRODUCTION

1. This chapter applies to all procurement undertaken in Defence and the Defence Materiel Organisation (DMO) having an estimated capital cost in excess of \$50 million and where there is an opportunity for entering long-term contracts (i.e. 15-30 years), involving asset based procurement.
2. This chapter outlines the policy applicable to Public Private Partnership (PPP) Projects where the public sector purchases services from the private sector under an arrangement where the private sector is responsible for the up front investment in capital assets and their subsequent operation, support, maintenance and refurbishment. This chapter replaces the previous Private Financing Chapter.
3. This chapter provides a broad overview of the PPP process. Due to the complex nature of PPP activities, projects considering using PPP should consult the Public Private Partnerships Branch in the Defence Support Group (DSG).

MANDATORY POLICY

- **The PPP delivery method must be considered for all project proposals having an estimated capital cost in excess of \$50 million and where there is an opportunity for entering long-term contracts (i.e. 15-30 years) involving asset based procurement.**
- **All projects meeting the above criteria must consult with PPP Branch in the Defence Support Group for the provision of advice on the suitability of a project proposal for delivery under PPP Arrangements.**
- **All projects reaching the *Project Assessment – PPP Suitability* checklist stage must consult with the Corporate Finance Review Unit, in Defence Chief Finance Officer Group, for an independent review of financial and budgetary impacts.**
- **Procurement staff must comply with the following legislation and policy documents:**
 - *Financial Management and Accountability Act 1997 (Cth);*
 - *Public Works Committee Act 1969 (Cth);*
 - *Commonwealth Procurement Guidelines 2008 (Cth);*
 - *National PPP Policy and Guidelines (December 2008) (Cth);* and
 - *Project Assessment – PPP Suitability checklist.*

OPERATIONAL GUIDANCE

BACKGROUND

- 4 Under a PPP arrangement the private sector is responsible for the provision of a capability and the design, construction, operation, maintenance and financing of the associated assets needed to deliver that capability. This whole of life integration under the responsibility of one party should deliver operational and/or financial advantages over a traditional procurement.
- 5 PPP arrangements should be performance based, with payment being conditional on the private sector delivering a specified output based service to a required standard. Payment under a PPP arrangement generally begins when delivery of the output required actually commences. Therefore, there is a strong financial incentive for the company to continue to provide the service to the required level. The services are generally self monitored by the contractor and if

the service is not provided the company will not be paid and in turn may not be able to repay its debts or provide a return to shareholders.

National Public Private Partnership Framework

- 6 On 29 November 2008, the Council of Australian Governments (COAG) endorsed the *National PPP Policy and Guidelines* and noted that the new framework would effectively replace the existing PPP policy and guidance applied by Australian State and Territory Government agencies. The new policy and guidelines replace Australian Government PPP and Department of Finance and Deregulation (DOFD) policy and guidance (FMG 16, 18, 19 and 21) with the exception of Financial Management Guidance No. 17 (FMG 17) - *Public Private Partnerships: Business Case Development*
- 7 The PPP delivery method must be considered for all major capital equipment and infrastructure projects having a capital cost exceeding \$50 million and where there is an opportunity for entering long-term contracts (i.e. 15-30 years) involving asset based procurement. Such projects must be examined to verify if a PPP arrangement may offer better value for money over traditional procurement options. This should be determined as early in the life of the project as possible.
- 8 PPP arrangements are most likely to be appropriate where there is:
 - a medium to high level of certainty of the capability required; and
 - a whole of life requirement involving a mix of assets and services.
- 9 Where the Australian Government considers that a project involves National Security issues, the National PPP Policy and Guidelines may not apply. Agency Chief Executives may put in place measures which allow such an exemption. Where an exemption is granted Agencies should:
 - identify the particular issues relating to the project which raise concerns;
 - determine alternative measures necessary to address those concerns; and
 - document the reasons for exemption from the National PPP Policy and Guidelines and obtain approval from their Chief Executive to use the alternative measures.

PUBLIC PRIVATE PARTNERSHIP SUITABILITY

- 10 Value for Money is the core principle to consider in deciding whether to use PPP arrangements. Value for Money should be assessed on a whole of life and whole of Government basis. Value for Money may be achieved through PPP arrangements when there is:
 - increased efficiency through appropriate risk transfer to the private sector;
 - cost savings achieved through innovation;
 - synergies achievable through a whole of life approach to design, construction and maintenance; or
 - additional revenue from third party use.
- 11 The Defence Committee requires consideration of PPP suitability at First Pass approval stage for all Major Capital Equipment and facilities projects – *Defence Capability Development Manual 2006* paragraph 4.44.
- 12 Before deciding to use PPP arrangements, the project's operational issues must be examined in a consistent and objective manner. It is required that:
 - the ability to deploy and sustain ADF elements and execute an operation is not to be prejudiced; and

- the application of combative force is to remain solely with the ADF.
- 13 PPP arrangements may be less appropriate where the asset acquired under the arrangement is designed or substantially modified for deployment in military operations. This is likely to reduce the amount of risk that can be transferred to the private sector.
- 14 The appropriateness of using a PPP arrangement should be initially assessed by considering the operational impact, practicality and financial viability of progressing a PPP option. As a minimum, a *Project Assessment – PPP Suitability* checklist will need to be completed for all applicable procurements. The checklist can be found at http://intranet.defence.gov.au/im/csir/part2/PPP_IM%20Guidance_feb09.doc. Where a project has characteristics identified in the Medium to High Potential range for a majority of the checklist questions (i.e. greater than 50%), it is possible that the project will be able to achieve a ‘value for money’ outcome under a PPP arrangement. In this case, a PPP option and associated detailed risk assessment should be considered as part of the project Interim Business Case.
- 15 For projects with an infrastructure component, a Corporate Services and Infrastructure Requirement (CSIR) Part 1 and CSIR Part 2 must be completed. The CSIR Part 2 has the *Project Assessment – PPP Suitability* checklist attached. Refer to Defence Support Group (DSG) [Infrastructure Management](#) for further guidance.

INTERIM BUSINESS CASE

- 16 The key stages involved in any capital investment decision consist of:
- government approving the preferred procurement method, generally at the point of seeking First Pass approval through the National PPP Policy and Guidelines Interim Business Case (including scoping study and Procurement Options Analysis);
 - government approving the investment (and funding as required); and
 - delivering the project: Release of Expressions of Interest, Request for Tender, selection of shortlisted tenderers, contract negotiations and contract execution (Commercial Close and Financial Close).
- 17 The National PPP Policy and Guidelines Interim Business Case approval must be obtained from the Minister for Defence and the Minister for Finance and Deregulation before proceeding with any PPP proposal involving projects valued at \$20 million or more but below \$50 million. Either the Minister for Defence or the Minister for Finance and Deregulation can refer the proposal to Cabinet for approval. PPP proposals involving assets over \$50 million require Cabinet approval.
- 18 For projects involving infrastructure, all Defence works estimated to cost \$15 million or more are to be referred to the Public Works Committee (PWC) before contracts can be awarded and works commence. The terms ‘Works’ and ‘Public Works’ have the meaning given to them in Sections 5 and 5AA, respectively of the *Publics Work Committee Act 1969* (Cth). Generally ‘work’ means architectural or engineering work including construction, alteration, refurbishment, repair, fitting out, demolition and the preparation of land for works.
- 19 Guidance on the process and requirements in development of the Interim Business Case can be obtained from the *National PPP Policy and Guidelines* and FMG 17.
- 20 The key steps of the Interim Business Case are:
- refinement of project scope and documentation of Project Plan;
 - communication with project stakeholders;

- further development of risk analysis;
 - development of the Public Sector Comparator and PPP Suitability Assessment Checklist;
 - Procurement Options Analysis;
 - assessment of market interest (market sounding activity); and
 - recommendation and submission to government.
- 21 Development of the Interim Business Case is a complex task that needs to be carried out by suitably experienced staff or with assistance from external specialists (members from the PPP Panel within Infrastructure Division).
- 22 The Interim Business Case includes financial modelling and development of a **Public Sector Comparator**. A Public Sector Comparator provides an indicative cost of delivering the capability through Defence purchasing the asset (as in a traditional procurement) and providing the service delivery by the most cost effective means. This may include contracting out maintenance support of the asset. A Public Sector Comparator provides a financial measure against which the PPP cost of meeting a specification can be compared. Further information regarding the Public Sector Comparator can be found in FMG 17 Appendix A.
- 23 Defence's established practices and strategies for engaging the market in a procurement process in accordance with the *Commonwealth Procurement Guidelines* are applicable where a PPP arrangement is pursued. A 'dual' tender process using PPP and an alternate contracting model should not be used. Establishing a preferred procurement method prior to engaging the market creates certainty and reduces transaction costs for the public and private sectors.

TENDERING PROCESS

- 24 Most PPP procurements will adopt a two-stage tendering process involving an Expression of Interest and Request for Tender.
- 25 The National PPP framework uses the term 'Request for Proposal'. The term used within Defence and the DMO is 'Request for Tender'.
- 26 Due to the complexity of PPP procurements, project teams should engage suitably experienced probity/legal process advisers to assist and provide advice on process and procedures including conflict of interest matters.

Expression of Interest and Shortlisting

- 27 The documentation released in the Expression of Interest should contain enough information to attract all relevant consortia, request sufficient information to ensure that a preliminary shortlisting of potential consortia can be carried out and provide details of the shortlisting process.
- 28 The initial assessment of consortia should be evaluated against standards required for technical capability and financial capability and management standing. Information should also be obtained detailing the skills and previous experience of consortia.
- 29 The information requested is required to rank the potential consortia and to select a shortlist of consortia who qualify for consideration in the next stage of the procurement. It is suggested that the number of shortlisted consortia be between three and four. While competition plays an important role in achieving best Value for Money, consortia should not be exposed to unnecessary expense.

Request for Tender

- 30 Shortlisted consortia are then asked to submit detailed tenders through a Request for Tender process. The information requested should be comprehensive enough to enable Value for Money comparisons to be made between the tenders and will usually include:
- details of how the specified output (design, construction and facilities maintenance services) will be delivered;
 - details of the tenderer's acceptance of the terms and conditions of the proposed Project Deed (contract);
 - industry involvement and development proposals;
 - details of how finance will be organised;
 - an account of the tenderer's willingness to accept the risks allocated to the private sector by the Commonwealth;
 - a declaration from the tenderer's financiers that they accept the tenderer's proposal in relation to risk allocation;
 - performance indicators and reporting arrangements; and
 - an acceptance by the tenderers of the payment mechanisms in the proposed contract.
- 31 A Tender Evaluation Plan should also be developed at this stage.
- 32 Details of the non risk-adjusted Public Sector Comparator are to be provided in the Request for Tender documentation. This provides industry with confidence that they have a clear understanding of the requirement. However, the Request for Tender documentation should not provide the detailed costing information for the project.

Evaluation of Tenders

- 33 The evaluation should be carried out in accordance with the principles and criteria set out in the Tender Evaluation Plan and Request for Tender documents.
- 34 Tenders should be sufficiently comparable with the risk-adjusted Public Sector Comparator that the project may proceed to contract negotiations with a high level of confidence that a suitable contract will be signed.

Negotiation with Tenderers

- 35 Negotiation of the commercial terms and technical aspects required for the project should be conducted with the shortlisted tenderers prior to any preferred tenderer being announced. This approach allows Defence to take advantage of competition between remaining tenderers. The negotiation process will allow tenderers to ensure that their proposal has been accurately understood and reconcile any outstanding concerns they have before selection of the preferred tenderer.

Selection of the Preferred Tenderer and Final Negotiations

- 36 The tender that represents best Value for Money in comparison to the Public Sector Comparator should be selected as the preferred tender. This will facilitate finalisation of negotiations between the parties to the proposed contract. There may be technical and commercial issues to be negotiated after the preferred tenderer is announced. However, the number of parties involved in a PPP arrangement can add complexity to the process.

FINANCIER DUE DILIGENCE AND APPROVAL

- 37 When agreement is reached between Defence and the tenderer on the draft terms and conditions of the contract the tenderer will generally have to secure final arrangements with its financier. The financier will seek satisfaction that money lent to facilitate the project is secure. This will involve the financier seeking to fully understand all of the risks involved in the project and satisfaction with how the risks have been addressed in the contract. The financier will also require confidence that the payment mechanism detailed in the contract will provide the consortia with sufficient funds to repay the loan.

CONTRACT SIGNATURE

- 38 Contract signature will not occur until after Commercial and Financial closure. Commercial closure occurs after negotiations between Defence and the consortia reach an agreed set of terms and conditions. Financial closure occurs after the financier completes due diligence assessments and agrees on their terms with the consortia.

CONTRACT MANAGEMENT AND PERFORMANCE REPORTING

- 39 Due to the long-term nature of PPPs, a high standard of contract administration and management will be required to ensure that the benefits of taking a PPP approach are sustained and the respective roles and responsibilities of each party are fulfilled. Whilst the contract may require the contractor to self-monitor its performance, ongoing performance monitoring is still required to ensure the output specified in the contract is received and that appropriate corrective action is taken if the contract requirements are not fulfilled.
- 40 The relationship between Defence and the consortium is to be maintained over a long contract term and the contract should specify the foundations of the relationship. It should include:
- sufficient and appropriate contract performance indicators;
 - a performance monitoring and reporting system which records the level of service delivered but is not overly complex or costly to run;
 - an appropriately structured performance management regime, which does not provide a disincentive to continuous improvement; and
 - independent reviews of the operation of the contract to ensure Value for Money is being achieved.

REFINANCING POST CONSTRUCTION PHASE

- 41 Consortia may seek to refinance their projects to improve the expected returns to their shareholders. Refinancing may include:
- extending the period over which the bank loan would be repaid;
 - reducing the lending margin of the loan;
 - arranging a fixed rate of interest to cover the full period of the loan; or
 - early repayment of the subordinated debt invested by the shareholders.
- 42 Refinancing of a project may occur as a result of:
- successful completion of the construction phase; or
 - the establishment of a successful track record in providing the service.
- 43 PPP arrangements are usually financially complex and Defence will need to consider the implications of refinancing on a project-by-project basis. The possibility of refinancing

occurring should be considered when planning the procurement. Aspects of refinancing that need to be examined include:

- the effect on the project achieving Value for Money, including changes which may affect the level of risk allocation/exposure of the parties;
- the effect on the stability of the contractual relationship between all the parties involved;
- contract provisions that require consent from Defence before refinancing can occur;
- contract provisions that allow Defence to share in some of the financial gains; and
- the requirement for experienced legal and financial advisers to assist projects in understanding the full implications of refinancing.

ADVICE ON PUBLIC PRIVATE PARTNERSHIP ARRANGEMENTS

- 44 The PPP Branch, Defence Support Group, is the leading authority for the provision of procurement advice on the suitability of project proposals for delivery under PPP arrangements. All proposals being considered for delivery under a PPP are to be considered by PPP Branch at the earliest possible opportunity.
- 45 The Defence CFO Group is the leading authority for the provision of budgetary advice relating to PPPs. Defence CFO must provide budgetary clearance for projects being considered or agreed as candidates for procurement under PPP arrangements at each of the following points in the project lifecycle:
- Initial Assessment of the Project for suitability as a PPP (prior to exercising of FMA Act Regulation 10 and Proposal Approver delegations);
 - Business Case Development; and
 - Tender Evaluation.
- 46 Defence CFO Group must be involved in the evaluation of tenders for PPP projects to evaluate the budgetary risks of the tender responses.
- 47 Information concerning the National PPP Policy and Guidelines can be obtained from Infrastructure Australia. Information regarding Public Works Committee and business case development can be obtained from DOFD.

KEY REFERENCES:

- *Public Works Committee Act 1969 (Cth)*
- *The National Public Private Partnership Policy and Guidelines, available at www.infrastructureaustralia.gov.au*
- *Department of Finance and Deregulation Financial Management Guidance No. 17 - Public Private Partnerships: Business Case Development*
- *Department of Finance and Deregulation Finance Circular No. 2009/02 - The National Public Private Partnerships (PPP) Policy Framework and National PPP Guidelines*
- *Defence Capability Development Manual 2006*

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