



Australia - time for a new debate on PPPs

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01 April 2009

Since their debut in Australia, Public Private Partnerships have been the subject of heated debate - and plenty of criticism.

They have been variously described as "shonky", costly, a cash cow for the greedy private sector, and as a way for governments to simply move debt off their books.

Much of this criticism is misguided and unwarranted.

It is true that some PPP projects have not delivered on investors' and private sector expectations. Mistakes have been made. This does not mean the PPP model itself is flawed or that the private sector should be shut out of infrastructure delivery.

There are many examples of successful PPPs in action - Melbourne's City Link and County Court projects are just two - which demonstrate the clear benefits of private sector investment in infrastructure - investment that will be needed if Australia is to deliver on its ambitious infrastructure program.

Let's first consider one of the chief criticisms of PPPs - cost.

Contrary to popular view, PPPs have proven to be more cost-effective than traditional models in their ability to enable the delivery of infrastructure on time and on budget.

A University of Melbourne benchmarking study released in December 2008 compared the performance of 25 PPP projects and 42 traditional style projects (where government finances design and construction by short term contracts) throughout Australia since 2000. It found the average cost escalation under PPP contracts during the construction phase was 4.3 per cent compared to 18 per cent for traditional procurement contracts. The average delay during the same period was 2.6 per cent for PPPs compared to 25.9 per cent for traditional contracts.

The PPP structure has built-in incentives for timely completion of major projects. Payments to the private sector are based on the delivery of the infrastructure in operational order. Private sector participants do not start to receive an income stream until construction of the project is completed.

It is also important to remember that the cost to government of major infrastructure projects is not simply the capital cost of the infrastructure. It includes the cost of maintenance, and in the case of some PPPs, operation of the infrastructure over a period of 20 to 30 years or more.

However, PPPs are not just about being cheaper than traditionally procured infrastructure projects. They are about achieving better quality and better maintained infrastructure over the long term, encouraging innovation and technological superiority in infrastructure design and delivery and allowing flexibility for expansion to meet the future needs of the communities they serve.

There is no 'one size fits all' PPP model. The challenge in the current environment is finding the right model for the right project to achieve the best outcomes for all stakeholders - the public, government, and the private sector.

Securing funding is the other major challenge for PPP projects in the wake of the credit crunch.

Currently there are calls for both State and Commonwealth governments to step in and provide funding for critical infrastructure projects. Such funding could be provided in a number of ways - through extending the function of the Rudd Bank, increasing governments' own borrowings, or through the provision of a Commonwealth government guarantee for the funding by banks in infrastructure projects.

Other suggested forms of government credit support to PPPs include government guarantees to shore up risk sensitive aspects of a project; for example, revenue shortfalls in an economic infrastructure project such as a toll road, or in a technologically complex project. Governments' assuming refinancing risk (that is, any increase in

financing costs on a refinancing and the risk that a refinancing will not be fully funded) has also been proposed by the private sector as a solution to the problem of banks' reluctance to fund projects for their full term.

Most recently Infrastructure Partnerships Australia prepared a detailed report entitled "Financing Infrastructure in the Global Financial Crisis" supporting some of these models.

In seeking solutions, it should be kept in mind that the current problems with funding of infrastructure projects are temporary. There is no need to permanently alter the PPP model and distort its risk transfer and value for money benefits.

Any such direct funding or credit support for PPP projects should be for the short-term. This is the approach the UK Treasury has taken with its recently established 'PFI bank'. It should also be provided within a structure which will give governments the ability to exit when credit markets improve and both bank funding and private sector investment in infrastructure begin to flow more freely.

Funding solutions should also recognise the need to retain some private sector debt and equity investment in infrastructure projects to ensure the discipline imposed by private sector involvement remains. It is this discipline which has led to the rigorous implementation of projects by the private sector, and is why the PPP model has proven to be an efficient and effective form of infrastructure procurement in Australia, delivering real value for money to governments and the public.

Instead of criticising the PPP model it's time for a genuine debate on infrastructure delivery that looks at the true cost and benefits of PPPs. As VECCI chief executive Wayne Kayler-Thomson recently observed, astute use of PPPs will be more vital than ever in the current economic climate. The focus of the debate should be on how the PPP model can work for these times, in which its major problem is a shortage of funding.

This article was written by Brad Vann, a partner at Clayton Utz. It originally appeared in The Age newspaper in Melbourne, Australia.