CORRECTED TRANSCRIPT

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Private Sector Investment in Public Infrastructure Subcommittee

Inquiry into private sector investment in public infrastructure

Melbourne – 27 January 2004

Members

Mr W. R. Baxter
Ms C. M. Campbell
Mr R. W. Clark
Mr L. A. Donnellan
Mr B. Forwood
Ms D. L. Green
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Mr G. K. Rich-Phillips
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Witnesses

Mr J. Fitzgerald, Director; and

Mr G. Maguire, Assistant Director, Commercial and Infrastructure Projects, Department of Treasury and Finance.

The CHAIR — I declare open the subcommittee hearing on private sector investment in public infrastructure. I welcome Mr John Fitzgerald, director, and Mr Glenn Maguire, assistant director, from commercial and infrastructure projects of the Department of Treasury and Finance. All evidence taken by this subcommittee is taken under the provisions of the Parliamentary Committees Act and is protected from judicial review. However, any comments made outside the precincts of this hearing are not protected by parliamentary privilege.

All evidence given today is being recorded. Witnesses will be provided with proof versions of the transcript shortly — usually in about a week. Before I call on the witnesses I ask that all mobile phones be turned off and pagers switched to silent.

Gentlemen, this is the subcommittee's final hearing and we thought it would be useful to get an update on the status of current PPP projects and to get an overview of how you see the policies of Partnerships Victoria evolving in the foreseeable future. Then there are a number of specific issues we would like to raise with you. Are there any introductory comments you would like to make? We are on a very tight time schedule, so if you could keep them brief we would appreciate it.

Mr FITZGERALD — Very briefly, it is now three years since the policy was established. We have brought some more policy material with us. There are a couple of additional technical notes that we produced during the last 12 months: one on the public sector comparator, and the other on discount rates. We will leave those with the committee.

From the point of view of the projects, we have moved on and nine projects have been closed — when I say 'closed', the contracts have been signed and we have reached financial closure — since the policy was established. They include two projects — one being the County Court project and the other the mobile data network — that in fact began as projects in the formulative stages prior to this government coming to power and this policy being put in place. Of those nine projects, the County Court is the only one that has been completed so construction is completed on that, and probably two of the water treatment plants have been completed as well. Other than that the other projects are still under construction, such as the Spencer Street station redevelopment. That is where we are at the moment.

As you are aware, the government has recently undertaken an independent review of not so much the Partnerships Victoria policy but certainly the approaches and guidelines that are used. That has recently been completed by Peter Fitzgerald. He is still finalising his report, which will go to the Treasurer, and the government will respond to that over the next couple of months. I am not in a position to really express opinions in respect of that review at this point in time because it is the responsibility of government as a whole to respond to that report.

One thing I would like to say is from our experience now of three years that review is very timely because there are aspects of the approach taken under Partnerships Victoria that could certainly be improved both in terms of outcomes for the state and the public and in creating some efficiencies for the private sector that is bidding for these projects. There will certainly be some changes and some finetuning of the policy as we go forward, and we would expect to be working on that throughout the course of this year.

The CHAIR — Mr Maguire, would you like to make any comments?

Mr MAGUIRE — I do not think so, thank you.

The CHAIR — I will start with the first question. It seems to this committee, from evidence taken overseas, that a driver in the PPP policy is government and Treasury's debt aversion. From the evidence we have gathered it is clear that in the end taxpayers fund infrastructure regardless of whether it comes under the PPP banner or some other. In the United Kingdom we heard of some interesting opportunities that the government and industry developed to provide public infrastructure but outside the PPP banner, or privately funded infrastructure (PFI) in the UK in particular. Examples of that included the national air traffic in the UK, the LIFT project and public interest companies, and where governance was a critical issue. Have you done any work on any one of those three or other potential projects of a similar nature?

Mr FITZGERALD — We are starting to do work on the LIFT program and taking a look at how that works in the UK, but that is the only area of change we have really started to look at. Given the current policy is only three years old, and yes, a number of projects have come forward under that policy, you need to get some runs on the board before you can actually spend a lot of time looking at how that policy evolves and what other structures might be appropriate.

The CHAIR — Is there anything particularly appealing that you have identified in the LIFT program?

Mr FITZGERALD — On the brief look and discussions I have had with people overseas I see one of the great advantages of the LIFT program where they have applied that process to more community-based type infrastructure — for example, medical diagnostic centres in the UK which are a partnership between private medical practitioners and government — and I think one of the benefits would be creating greater involvement and ownership of the project within local communities. I do not see it as necessarily changing the financing arrangements that sit behind it, but having much more of a partnership arrangement, not just Victorian government and private sector parties but local communities and representatives as being quite important.

Mr CLARK — Could I pick up on your reference to the fact the program has been running now for about three years and the number of projects that are currently operational. To be blunt I put to you that there seems to be evidence that it is taking a long time to get projects up and running under Partnerships Victoria — to take one example, the metropolitan radio network which has received some recent attention.

My understanding is that that was due to be completed in time for the Commonwealth Games, and that is now in doubt. I understand this project was announced back in May 2002, yet bids for it have still not closed, the time lines have fallen back and they are not due to close until February. Why is it that projects are slipping so much against their time lines and taking so long to get to the market, to get signed off and to get built?

Mr FITZGERALD — You have to look at the entire project time frame from the very inception of the project and the feasibility study right through until the project is actually completed and delivered. Yes, having the mobile radio project in place prior to the Commonwealth Games is critical. Those times lines are now somewhat on the critical path, but we are still very much aiming for that to be in place. That is still achievable and that is what is proposed by bidders at the moment.

I think it is fair to say that Partnerships Victoria projects do take longer in signing the contract because a lot more of the work is done up front. With traditional procurements — I guess I am speaking somewhat objectively and from experience because I think the work has not been done to actually test this yet — it is easier and quicker to get on with the projects that are being developed under traditional procurement. So you go out more quickly to the market and ask for the market to bid on a D and C — a design-and-construct-type contract — but historically what we have not looked at is whole-of-government delivery of the service. You can get a contractor on board, get construction happening fairly quickly, but if you have not thought through that total construction approach and the risks associated with that, there is a great danger that the time lines in terms of construction actually get extended. Then there is the risk of commissioning and operating that facility which also has some problems.

So yes, you are right, a lot more time is spent up front. We are still strongly of the view, and we need more evidence to support this, that the total procurement process through the construction and operation of that facility will be more efficient given that work up front has been done.

The CHAIR — By way of supplementary, when we were in the UK we were advised that from the signing of the actual contract to the delivery there was a shorter period of time but, as you have just explained, there was a significantly elongated process prior to the actual signing of the contract. We asked the UK government representatives — and I am asking you the same thing — after what you have learnt in contract negotiations and specifications in the PPP process, what lessons can be learnt and transferred into normal procurement as a result of PPPs? 'Are we doing it properly?' would be the first part of the question. Are we learning and then implementing that outside the normal procurement?

Mr FITZGERALD — I think we are; I would certainly like to think we are. One of the roadblocks I have found since being in this role is in the development. If you look at mobile radios there is a period of 12 months approximately from the feasibility study and the project coming forward as something the government might want to consider before getting to a point where you can go to the market in any form to tender the project, whether it is under PPPs or traditional procurement. There is some clear evidence, whether it is PPPs or traditional procurement, that if that work is not right in that first 12 months, it will cause significant delays. Getting that work right is very much around getting the business case right, looking at the various options and looking at the full costing of the project.

If you do not do that it causes problems for government because costs continue to go up in terms of what might have been originally promised. The second key issue is getting all the stakeholders involved. I think that is an area where government can continue to improve; there are lots of interested parties and stakeholders. They need to be involved early. They need to be involved in the evolution of the business case, and if you leave stakeholders out of that process, inadvertently or otherwise, it creates delays when you are trying to get approval through cabinet for the funding. So I think that is important.

Just one more word: with PPPs when we have got to the point where we go to the market — if you look at the Berwick hospital, for example — the tendering process from the expression of interest going to the market to the signing of the contract was just within 12 months, and most of our projects are being contracted within that period of time under PPPs. If you look at the United Kingdom experience, it is probably a faster time frame than what historically has been achieved in the UK. I do not think we can improve much on that, except creating different processes, but it is that front-end work that is absolutely critical; if that goes off the track it takes forever to get it back.

Mr MAGUIRE — The government introduced a gateway project last year, which is a process to try to help enable capital works generally to be done more efficiently. That program results from a lot of lessons learnt from our PPP type of work. We have now got much more robust structures for doing business cases for all our major capital works processes. We now have gateway reviews of major projects at different decision gates. That gate idea was picked up from the United Kingdom, but also from PPPs we have definite gates in the process with PPPs that have to be approved by the Treasurer and minister or have to go back to the cabinet committee. So we put in place quite a lot of rigours from that PPP process into our wider capital works delivery. Some other examples include that the risk assessments of the likely risks of projects are now done much more fully for projects generally than they were previously; also looking at whole-of-life costing and issues beyond the capital works period are now done much more fully up front than previously.

Ms ROMANES — To follow up the discussion, how reliant is the government on consultants during this front-end process; have you done any work on costing both the transactions and the percentage of those costs that go to consultants; and are actions being taken to improve the capability of the public service to match the private consultants in these negotiations and transactions?

Mr FITZGERALD — Perhaps I might start by saying that I am not convinced yet that the cost of consultants with respect to a PPP project is necessarily that much higher than the cost of consultants in a traditional procurement. There is certainly a different emphasis: PPP contracts are much more commercial-type contracts rather than just going and building something, so you do spend a lot more money on financial and legal consultants. However, with a traditional procurement you do spend a lot more money on technical consultants — that is, engineering and design consultants, et cetera. The project still has to be designed and engineered, but under a PPP the private sector actually picks up a lot of that cost and builds it into its bid.

I do not know the outcome. We need to do some work. In fact the Department of Justice has asked us in Treasury to undertake some of that work for it to see where those costs are. Having said that, we certainly acknowledge that the cost of financial and legal consultants is very high. What the government has done there is establish a panel of financial consultants with specialised expertise in PPPs. Out of our unit in Treasury we manage the engagement of contractors, and we certainly have pre-established rates et cetera for them, and then there is a whole-of-government panel for the selection of legal advisers. Again there is a special section within that panel that caters for legal advisers that advise on these sorts of projects.

The first area we need to provide some training within government is how to manage consultants. Consultants are very skilled at generating revenue for themselves and their firms, so the first thing we need to do is understand how we need to manage those. We have now produced a draft guide or document that might help departments do that.

In terms of improving the expertise within government, I absolutely agree that is something we need to continue to do both in terms of managing those that are involved and in terms of greater understanding of infrastructure generally and the issues associated with it. We have taken some steps to address that situation.

Through Melbourne University Private we have established a training program for professionals who will be involved in PPP projects. People from both the public and private sectors can attend these training courses. I think we have had just over 100 people undertake those programs, and they will continue. Again with Melbourne University Private we have established a body of people that is known as the Australian Centre for Public Infrastructure. Through Melbourne University Private that organisation is running some Masters courses. So we now have three people from government in Victoria undertaking the Masters course — again there are some from the private sector; there is another intake and that seems to be spreading quite well. They are undertaking quite specific research topics within that program. There is a lot more to be done yet, but I would like to think we are at least addressing it and moving on.

Mr MAGUIRE — The unit has had quite a few people now who have been there for two or three years and have worked on quite a few projects. The skill level has been rising within the Treasury unit over that period. So we think the people in Treasury can now have a greater influence in the projects than they might have in the past. It would be very hard for the small senior core in Treasury to have the detailed involvement that you need across these projects, but as the younger people get more experience now I think you will see that experience spread much more fully across government.

The CHAIR — How many staff are you talking about?

Mr FITZGERALD — Those in my group working on PPPs number about, let us say, 20 — about half my staff.

Mr RICH-PHILLIPS — I would like to ask you about one of the current projects, that being the Commonwealth Games village at Parkville. It is my understanding that that is not being developed under the Partnerships Victoria program, although it is obviously a PPP. Can you explain what the assessment process was for that when that model was being examined by Treasury?

Mr FITZGERALD — I probably cannot say a lot about it, only because I was not that involved in that process. I am sorry, I just do not know a lot about it.

The CHAIR — You could take it on notice, if you wish.

Mr FITZGERALD — I think I would be better to do that, because I would be guessing otherwise.

Mr RICH-PHILLIPS — It was obviously done outside your unit then?

Mr FITZGERALD — Yes, it was. We were not involved in that process.

Mr RICH-PHILLIPS — Do you know who did do the process if it was not Treasury?

Mr FITZGERALD — Funding was allocated for all the Commonwealth Games-related projects, the games village being one of those. And because there is a separate department and minister responsible for that, as I understand it, all of the funding for the Commonwealth Games came as a package to the expenditure review committee. So that would have certainly come through the budget area of Treasury, but because it was a total package I think it was considered outside our area of responsibility.

Mr RICH-PHILLIPS — Even assessing the individual project?

The CHAIR — That has already been taken on notice.

Mr RICH-PHILLIPS — I am trying to flesh out why it was not done through the Treasury.

The CHAIR — Mr Fitzgerald said he does not have in-depth knowledge of it and he did not want to guess. As Chair I think that is a fair call. If he has taken it on notice and he does not want to guess, the subcommittee will get the written reply.

Mr RICH-PHILLIPS — All right. Are there many other projects that would be assessed elsewhere other than by your unit for PPPs?

Mr FITZGERALD — Yes. We do not necessarily assess every project that comes to government. I think progressively over time, as our expertise has improved — and I guess that there some recognition of that within government — we are seeing more, and I would suggest now we would see most of the projects that are coming through the budget process. But certainly 12 months ago that was not the case. We would tend to look at a high level of projects that might be flowing through from our group and we might recognise from very little information that something clearly seems to have the characteristics that mean that a PPP process might add value, but I still would not suggest that we see every infrastructure project that is coming through. I am not sure that we should — it is a pretty big job.

Ms GREEN — I wanted to ask you a question in terms of the time the process takes. You talked about learning more as you go along and things like that and said that in traditional procurement time lines can blow out in the construction phase. But particularly the critics in the United Kingdom say that it is not really a fair comparison, because the line that is sold to governments continually is that you get speed of delivery through PPPs. But if you are not comparing the whole time, including the time before the 12 months that you talked about earlier, it is really not a fair comparison of the two forms of procurement.

Mr FITZGERALD — If I am not answering the question correctly, please tell me. I think the first phase is this initial feasibility phase, that first 12 months — it can be longer, and some projects kick around for years — to get to business case. That process, particularly as it goes through the gateway, should be the same, whether it is traditional procurement or whether it is PPP. It should not make that much difference. There is probably a little more time spent on PPPs to look at whole-of-life costings. Yes, there is a longer process with PPPs in that first 12 months or so. Then you go through the tendering process. Again that is longer because you are tendering the entire project, so that could be six months longer than the traditional approach. But then what we are finding is that you should be picking that up through the construction stage. It might be worthwhile saying something about that.

I think the obligations on the private party — and this is where the benefits of PPPs should flow from — are much different once they are into a contract because they do not actually get paid until they start providing services, whereas under a traditional procurement, in very simple terms, the contractor gets progress payments as he builds, so he really does not have the same commercial incentives to get it finished and get on with it. So there is a very distinct difference there.

We have never professed in Victoria that the PPP procurement process would provide any efficiencies or savings in time as a procurement method. Our desire to undertake a PPP is based entirely on a value-for-money outcome, so it is looking at the whole-of-life process. So if the United Kingdom is suggesting that PPPs should reduce the length of the process, I am not sure I would agree with that; it is certainly something that we have never professed to be the case here.

Mr BAXTER — In your opening remarks you made reference to doing some more work on the public sector comparator (PSC), and I will be interested to read that, even if I have difficulty in understanding it. Is the extra work that you have done simply a technical note or is it saying, 'Look, perhaps in the past we have been putting too much emphasis on the PSC and to a degree it is an artificial thing that is capable of manipulation, or what do we include and so on'?

It seems to me that with traditional procurement we do an estimate and then we go out for bids, and we either accept them or we do not. PPPs are much the same thing but we seem to be spending so much time on getting this PSC done. Yet if you look at something like a water treatment plant that is going to be a build, own and operate scheme for 25 years, say Echuca-Rochester, how does the public sector estimate the risks in the PSC? Have we been spending too much time on the PSC, all of it artificially, and that is putting up the bid costs? We know the bid costs are very high for PPPs, not only for the bidders but for the procuring government as well.

Mr FITZGERALD — It is a very good and interesting question and intriguing in a way because without the PSC what governments have traditionally done, not just Victoria, is that they will cost out a project, add a contingency to it because, 'I think that is about where it will be', and then everybody gets very upset when in fact the contingency was not sufficient and risks have occurred that have driven up costs and driven out the timeline, and nobody actually thought about it or did the work on it to understand what those risks were. So we now produce a PSC which factors in as many of the risks and delays that we reasonably believe are likely to occur, using technical advisors to say, 'If this happens, what impact will that have?' et cetera.

Now we have people asking us questions about whether we are doing too much work to try and nail those risks down. I find it a little intriguing that we have gone from one approach, which clearly did not sufficiently establish the risk profile of a project, to saying that we have an overly robust approach to people who are saying, 'You are spending too much time on it'. Perhaps the pendulum has swung a little far. I would be quite reluctant to move away from the PSC.

If you look at the private sector, to BHP Billiton or somebody, they will do exactly the same thing in costing their projects. They will spend a lot of time understanding what the risks of the project are before they make a decision. I think the thing that can be used going forward is the use of greater empirical evidence. So where we have built hospitals before, both privately or publicly, what has the outcome been and what is the benchmark that we may compare these risks against?

They have certainly done that work in the United Kingdom; that sort of work has been done through Mott Macdonald, which I am sure you have heard about. So perhaps there is something in the middle that is more efficient than the approach we are using, but I would be quite reluctant until that empirical evidence is there to move away from the very robust approach to risk that we are taking through the PSC. One of our research students is undertaking that work through Melbourne University Private, to have a look at the risk profile of a large selection of projects to see where that risk possibly lies.

Mr MAGUIRE — I have two additional brief comments. There seems to be widespread belief that the PSC has been the only thing that is used in evaluating bids, and I really want to make it clear that if we look at other matters apart from just the PSC. We always have done that, so I just want to clarify that distinction. There are things like technical standards, risk transfer and things like design issues, so you have a whole lot of other issues as well.

The other issue is that doing a very detailed PSC helps us to work out what the actual cost is going to be and whether or not our budget is sufficient and whether we then need to scope back the project or seek more money upfront. It has really been very useful in that regard by helping us work out what our budget is. Often in the past with non-PPP projects, the initial work has been done fairly quickly, the costs have not been estimated that accurately and the costs are invariably much higher than what people thought.

Mr FORWOOD — Maybe that is right; we were not doing the work properly before. I think one of the issues about the public sector comparator though is that you tend to get the impression that the public sector could do it itself, and of course it cannot. If you take the mobile data network, did someone do a PSC for that project?

Mr FITZGERALD — Yes.

Mr FORWOOD — So someone has artificially built a model about something that the public sector could never deliver. I put it to you that the best way of finding value for money is to go to tender in the market and have two people out there competing for the job and you then assess what you get back because you spend massive resources on developing a PSC for a project that you do not have the expertise nor the desire to ever build.

Do I get a comment back? I was expecting a comment.

Mr MAGUIRE — You made your comments.

Mr FORWOOD — It was a polite way of doing it.

Mr MAGUIRE — That comment is often less true for a hospital or a prison. You are thinking more about some of the particular IT projects in that regard, I would think, more so than projects generally like a road or a prison or a hospital or — —

Mr FORWOOD — I think you have to have robust mechanisms in place in order to assess what is happening, particularly because we all accept that this is about value for money. But how you do it is important and I do not believe in a number of cases that you should be spending the time and the resources on constructing artificial models which we all know can be — well, manipulated might be a touch strong — but we have had evidence given to us that people muck around at the fringes to get the results they want, when in fact the better way of getting the decision made is not to spend your time and resources on that, but to go in other directions. That is my question to you.

Mr FITZGERALD — I think the point Glenn makes needs to be taken into consideration if it is a hospital. If it is something that government could procure, then I think you are saying that the emphasis is somewhat different.

With ICT-type projects you are right, we cannot deliver them but the PSC does have another purpose. One of the major differences between here and the United Kingdom is that when we do the PSC that goes into the state's budget at that point in time. So the PSC is not just a benchmark about what it might cost us if we were to build it, it also locks in the numbers that go into the budget and then government holds very firm on that.

Your argument — that you might be able to assess what the budget cost of the project is without going through the full PSC approach — perhaps is still a good one but it is important that the PSC has two purposes and is open to discussing that further. The other thing is that with one of these ICT projects, we have two or three private sector parties bidding so you should still see the most efficient bid flowing from the process regardless of what the PSC did or did not tell you.

The CHAIR — Can I just have some clarification before Mr Baxter follows up? You said that the PSC allows you to lock the appropriate figures into the budget and then you go out to the marketplace. In doing that it signals to the marketplace what the state is prepared to pay.

Mr FITZGERALD — We will not tell the marketplace the full PSC.

The CHAIR — But if it is locked into the budget how does the Parliament know?

Mr FITZGERALD — It is locked into the internal budget numbers. Berwick was one case where budget papers had to be released but the PSC did not go into the published numbers and there was a footnote which said that because we were in a tendering process, we did not publish. So they are numbers that are known internally, not externally.

The CHAIR — Okay. Mr Baxter, is your supplementary in relation to the last comments because Mr Donnellan has also got a supplementary question?

Mr BAXTER — No, it is to follow up on where I started. Going to your technical note, is it just a technical note in the true sense of the word or is it actually drawing on the experience that we have now got and in some senses giving a bit of a template to people so we have not got to reinvent the wheel on every occasion? Is it possible to have a template in putting together the PSC for each project or have we got to go from scratch each time?

Mr MAGUIRE — The technical note that we put out in July includes quite a lot of lessons learnt from previous projects, and they are covered in here. It focuses a lot more on how to value risk, which people are finding very difficult. It gives a very detailed work example of how PSC is done and how risk can be measured, and it gives two examples — one for a simple project and one for quite a difficult project, and different degrees of detail are included.

We do not go as far as putting in a template on how to do a PSC in each particular case. We are now thinking about whether as a further project we might start to do that. We did not want to issue templates too early because then they might not go and do the proper upfront work themselves but we are getting to the stage now where we think that we can start giving them a template and they will understand the issues involved.

The CHAIR — By way of clarification, when is the PSC done; at what point would you say it is final?

Mr MAGUIRE — It is not fully finalised until before the bids come in. It keeps on getting developed. It will be done to a fairly good stage before the expressions of interest document goes out but it will keep on being refined as we refine the risk allocation in our draft contract which is not released until the project brief goes out, and until we refine the performance standards, including the KPIs, going into the contract. But they are not fully developed until the draft contract goes out. Once the bids are out the PSC might be modified a little bit but it will certainly be finalised before the bids come back in.

The CHAIR — Thank you.

Mr DONNELLAN — The provision of infrastructure by the private sector and the competition in the marketplace is still relatively small. There are a certain number of providers who have bid previously. Has Treasury done any work on looking at tax structures and so forth, whether it be at a federal or state level, which are an impediment or otherwise to getting more people into the marketplace to compete for the provision of infrastructure within the PPP system?

Mr FITZGERALD — There are two federal government tax provisions, division 16D and division 51A(d) that are an impediment to procuring infrastructure under PPP arrangements and we have been debating this under the ambit of the heads of Treasury. I think it is fair to say that out of Victoria we have been chairing a group of public servants across the various states and at the federal level.

Over the last 12 months we have been leading the charge on approaching the federal government to appropriately amend or change those provisions. We have been working very closely with organisations such as the Australian Council for Infrastructure Development and others. You are probably aware that Senator Coonan has publicly announced that she intends to review and is reviewing those provisions. They are impediments. Given that we are having a struggle actually convincing the federal government to remove some of the impediments, it would be very hard to convince it that it should do something that improves the likelihood or outcome for these types of projects. We would be quite happy to improve what we have at the moment. A lot of work has been done over the last 12 months, and we have been very involved in that.

The CHAIR — If you believe any of that would be helpful to the committee, we would appreciate hearing it.

Mr CLARK — Can I come back to the issue of timeliness of PPP projects and two aspects of that? First of all in relation to the metropolitan mobile radio, could I clarify your previous answer? Do I take it that the project is still intended to be completed in time for the Commonwealth Games — you mentioned it was on the critical path? I have been informed that the police force had been told that the project completion had been delayed until after the Commonwealth Games, so could you clarify that?

Secondly, there is another project, which is dear to my heart because it is in my electorate, and it is a good example — that is, the car park for Box Hill Hospital. I understand the time line of the proposal for this project was that it went to Treasury in early 2001 for approval as a PPP and that the tender documents went to market in July 2002. Apparently the project was abandoned in September 2002 when none of the bids met the tender requirements, but the project is still listed as active on the Partnerships Victoria web site.

To take that second project as an example, why did it take so long from the time the project reached Treasury to go to the market, and how was it that the project fell over so quickly the minute it got to the marketplace? Is that an example of the fact that these smaller projects are not suited to be done under Partnerships Victoria?

Mr FITZGERALD — Perhaps I will answer that question first and then work backwards. It is a good example of where a smaller project, one without a lot of complexity, probably is not suitable for Partnerships Victoria. I would have to take on notice your question as to why it took so long for the funding decision to be taken in Treasury and then for the project to go to the market. I am happy to check that for you.

But you are correct; it did go to the market. We did not see bids that provided value-for-money outcomes for the state. Bids were compliant in terms of technical compliance because it was not difficult to do that in terms of a car park. But they certainly did not provide the value for money that we believed we should expect.

As it turns out, it is much better that the state goes ahead and builds it because it will be cheaper and less expensive to operate. That was the decision taken.

Whilst it means that a project has been further delayed because the process did not provide value for money, it also demonstrates that the state is serious about value-for-money outcomes. I could take this on notice and provide an accurate answer, but I understand that funding is now being provided to the hospital through the Treasury Corporation of Victoria.

Mr CLARK — I would like to clarify the time lines for the metropolitan mobile radio system.

Mr FITZGERALD — Unless somebody has not told me something — I do sit on the ministerial steering committee for the Department of Justice — it is still online and needs to be delivered prior to the Commonwealth Games. As far as I am concerned there is no question, view or belief that those radios will not be available for the Commonwealth Games. If at some point the government believes that might be the case, then there would have to be a contingency plan in place at additional cost to the state, but as yet nobody has raised it as necessary.

Mr CLARK — Why have the time lines slipped from the original completion as at December 2004 through till now, right up against the critical path to the Commonwealth Games?

Mr FITZGERALD — The problem with these IT projects is that they are quite difficult to scope in terms of technical requirements and outcomes. More than one emergency service uses the radio, so the different emergency services have different requirements in terms of portability and in terms of where they need coverage et cetera. Actually working through technical and other issues of how these radios will work or whether they are data networks is a very complex and difficult area. The delays also have been around scoping the tender documents correctly in terms of technical requirements more than anything else.

Mr MERLINO — My question is about sustainability of PPPs. One of the issues constantly raised with the committee from a bidder's perspective is the issue of deal flow, having some certainty of activity in PPPs, and whether that would be the government releasing a program of PPP capital works or projects over a 10-year period. Could you comment on that? Also, on the flip side could you make some general comments about the maturity of the market in Australia?

You have made comments in regard to the impediments and the tax perspective, but could you make some general comments about the maturity of the market? For example, I note that there have been takeovers of a number of companies. Has that made the pool of companies bidding for projects in the future a bit smaller?

Mr FITZGERALD — Yes. In answer to your first question or comment, a continuing pipeline of transactions is critical to the development of PPPs not only in Victoria but in Australia. We have been working closely with the other states to encourage a national approach to developing a pipeline. I guess with the announcement made late last year by the Premier that he would encourage the development of a national PPP council, that would be one of the very things that that council would need to work on.

It would also be helpful for the state perhaps to provide a more forward-looking assessment of what projects could be funded and may well be delivered under PPPs. This will all go to confidence building within the private sector to retain their teams and build their expertise. It depends on what we are talking about.

To make something clear in terms of expertise and experience in bidding for these types of projects or private sector involvement in financing these projects, the Australian market is quite mature; it goes back to the previous Liberal government in Victoria and beyond, and it is the same in other states.

In terms of experience, it is quite mature. In terms of the depth of the market, yes, it still needs to be developed. You are correct; a number of major construction companies have amalgamated, so when you are dealing with a very large project, that is becoming an issue. There was a recent announcement of cooperation between Transurban and Macquarie Bank, which did not affect our project, but it has significant ramifications for other road projects in Australia, particularly in New South Wales, which is developing a number of new projects.

Sometimes I believe we could do more to create international interest in our projects. Certainly a number of facilities or management-type companies, for example, operate in the United Kingdom but do not operate here. So the pipeline would perhaps help further marketing of the opportunities here in Australia, and that is something we should be doing more of.

The CHAIR — By way of a supplementary question on that issue, if we are talking about deal flow and flagging future projects, when you use the term 'pipeline' are you referring to projected PPP projects?

Mr FITZGERALD — I see the pipeline as containing those who are alive in the market today and those to whom the government has made a commitment to come into the market. Even beyond that, the further you look out, the less certainty there is.

The CHAIR — I wanted to be clear on the term you were using — that is, 'pipeline'. By way of a supplementary question, if we are flagging a PPP pipeline, has any work been done of a similar nature in traditional procurement? For example, infrastructure builders will still build whether it is a PPP project or a traditional procurement, be it a school, hospital or a road. So that we make sure there is not a two-tier system — and this was a recurring thing when we were overseas — one that is PPP funded with facilities management locked in, and the other a traditional system. What work has been done on making sure one does not race ahead of the other to build a two-tier system?

Mr FITZGERALD - We are starting to do some work on that. When I talk about a pipeline, I think that as you look out beyond those on which a decision has been taken that they will be PPPs, then that pipeline needs to include all potential infrastructure projects, because it will only be over time that they emerge as being one or the other.

As part of the Gateway process that Glenn referred to earlier, we have now developed what Treasury wants to see in the annual budget bidding process each year — that is, a multi-year strategy. As part of that process government is now asking departments to flag infrastructure needs up to 10 years out. At 10 years away something might appear to be a speck on the horizon, but at 5 years you are starting to recognise that it is a ship, and only 1 or 2 years out will you decide whether it is a yacht or a motor boat. So we are wanting to build that into the forward planning, and that will start to allow us to develop a more defined pipeline, then progressively highlight where projects might be best suited.

Ms ROMANES — I understand that there are different approaches in other jurisdictions with regard the discount rate. Can you give us a view on the discount rate?

Mr MAGUIRE — It is a quite complex area, but I will try and keep it as high level as I can. We will dig down if we need to, beyond my initial comments.

The discount rate issue was looked at in some depth by the Heads of Treasury group some time ago. Nothing has been published formally out of that context, but there was agreement to a certain approach based on the capital asset pricing mechanism. New South Wales and Queensland follow the agreement that came out of that HOT group work to the letter, in a sense. Victoria also follows that approach but Victoria also has a simpler approach for the more simpler projects.

As is outlined in this discount rate document that we put out in July, for simpler projects we have a simpler approach. The approach is different to that of the United Kingdom, which used quite a high number until earlier last year and has since dropped the rate dramatically. It is worth noting that the rate over there is currently 3.5 per cent real. It is based on what is called a social time preference concept, which comes out of welfare economics. It is about what people are prepared to forgo as a society compared to the next generation. The rate over there is still well above their risk-free rate, which is around about 2 per cent.

If you translate that to Australia — a risk-free rate of around 3.5 to 3.7 per cent — you would have similar rates if you use a similar differential where you have a rate of just over 5 per cent real, which is a rate we currently use for most of our PPPs and certainly all of our social infrastructure PPPs. So it is similar real rate to what the UK is using, although we get to it in a much different manner. You are right; we can speak on this topic for hours, depending on what the specific question might be.

Mr FITZGERALD — In summary, predominantly the states and Victoria take the same sort of approach. As Glenn said, the approach we are taking in Victoria on simpler projects is a bit more streamlined than they are taking in other states, but fundamentally it is the same approach and the same theory. The UK used a similar theory, but has changed that recently. I am sure we will have another look at the discount rate issue and look at what is occurring in the UK.

We have a very open mind to that, but it is important to understand that both are complex and that you need to dig into the UK's approach as well because there are a couple of things regarding their approach. On top of the discount rate they use an optimism-bias contingency risk, so you have to look at all of that together before you can work out what might be the better approach.

Mr FORWOOD — I have a quick supplementary question. In the middle of last year you established the new system, which is a 5 per cent, 6 per cent and 8 per cent discount rate depending on the different projects. Are you flagging to the committee that it is likely that you will change those again?

Mr MAGUIRE — We are simply saying that with the Peter Fitzgerald review we are, I think, obliged to go and at least look at his recommendations and consider them further as part of the government's response to his report.

Mr FORWOOD — A very diplomatic answer.

The CHAIR — By way of supplementary, in the global market if you were a business looking to invest in a PPP project and you had a discount rate here as outlined and a discount rate in the UK as outlined, it would be fairly clear where you would head to do business, would it not?

Mr MAGUIRE — Why is that? With the rate here being higher?

The CHAIR — Perhaps if I put it as a question: how significant do you think the variation in the discount rate would be in a global market for a business to decide to do a project in Victoria or somewhere else in Australia or the UK?

Mr MAGUIRE — I would not think it would make much difference — it really would come back to the rate of return they think they could get out of the project. That would be the most fundamental issue.

Mr FITZGERALD — To pick up on your point before, if you actually work through the approach they are taking in the UK, it is a different approach in theory, but if you work those theories you will end up with pretty much the same answer. I do not think it really makes much difference.

Mr MAGUIRE — The real rate here is actually very similar to the UK because our interest rates here are higher than those in the UK: their 3.5 per cent rate translates to about a 5 per cent rate here anyway.

Mr FITZGERALD — It is pretty much the same in both jurisdictions. The only thing I would add, and this is a personal comment, is I think our theory — the capital asset pricing theory — is probably better understood by financial markets than the approach they are taking in the UK.

Mr CLARK — If I could quickly clarify that, the Chair's point is that the lower the discount rate, the higher the capital cost of the private sector bid and therefore the harder it is for the private sector to come in with a winning bid. Therefore if you dramatically lower the discount rate it will make businesses much more reluctant to enter the market because they consider it a lot more difficult to beat the PSC. Surely that point is a fair one.

Mr FITZGERALD — That is correct, yes.

The CHAIR — I thank both Mr Fitzgerald and Mr Maguire for making time available to us this morning. I personally have found it extremely helpful and from the questions asked and comments made I am sure others have also. You will be receiving the transcript shortly. We look forward to sending you some follow-up questions and you have taken a couple of items on notice. Thank you very much.

Witnesses withdrew.

CORRECTED TRANSCRIPT

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Private Sector Investment in Public Infrastructure Subcommittee

Inquiry into private sector investment in public infrastructure

Melbourne – 27 January 2004

Members

Mr W. R. Baxter
Ms C. M. Campbell
Mr R. W. Clark
Mr L. A. Donnellan
Mr B. Forwood
Ms D. L. Green
Mr J. Merlino
Mr G. K. Rich-Phillips
Ms G. D. Romanes

Chair: Ms C. M. Campbell
Deputy Chair: Mr B. Forwood

Staff

Executive Officer: Ms M. Cornwell

Witnesses

Mr R. Bartlett, Policy and Public Affairs Analyst; and

Mr B. McNamara, Chair, Planning and Infrastructure Committee, Property Council of Australia.

The CHAIR — I welcome Mr Robert Bartlett, policy and public affairs analyst from the Property Council of Australia and Mr Bernard McNamara, chair of the Property Council's planning and infrastructure committee.

All evidence taken by this subcommittee is taken under the provisions of the Parliamentary Committees Act and is protected from judicial review. However, any comments made outside the precincts of this hearing are not protected by parliamentary privilege. All evidence given today is being recorded and witnesses will be provided with proof versions of the transcript shortly.

Mr Bartlett and Mr McNamara, this is the subcommittee's final hearing and we thought it would be useful to get a briefing on the major issues raised in the *Funding Urban Public Infrastructure: Approaches Compared* report and on the Property Council's response to the Peter Fitzgerald report on the *Review of Partnerships Victoria Provided Infrastructure*. Then there are a number of specific issues that we would like to raise with you. Over to you, if you could keep your comments brief — unfortunately, our time is very limited.

Mr BARTLETT — Thank you very much. Thank you for inviting us today. Firstly I would like to introduce Bernard McNamara from the Gandel Retail Management Group; he is the chair of our planning and infrastructure committee. Karen Janiszewski from Baulderstone Hornibrook who looks after infrastructure for us was unfortunately not able to attend today due to illness; I am not doing too well myself but we will plough on.

The reason we looked at public infrastructure is our cities need it to continue. We need public infrastructure to maintain a solid economy and to keep economic growth strong. We had very significant concerns about the way in which producer or development levies were being applied in a fairly ad hoc manner and being applied in different ways to different projects.

New South Wales in particular has quite a history of doing that so the New South Wales division of the Property Council commissioned the Allen Consulting Group to have a look at the various ways of funding public infrastructure and in particular to see which stacked up the best and to show how developer levies stacked up against the rest.

I just refer you to a couple of articles that have been in the papers in the past couple of days; I will give you copies later on. You may have noticed this in the *Age* last week, which is about roads in Victoria and how the number of cars and the level of traffic is getting to the point where roads are insufficient to meet the demand.

The other one, which had such a nice picture, concerned wooden country bridges that are not able to meet the demands placed on them; there are quite some around. There are many, many examples you could give of that. Engineers Australia did a major report very recently which rated Australia's public infrastructure at a D minus which is a fairly strong result.

Those sort of concerns led us to consider the questions we asked Allens. They used the MMRF model — the Monash model — which I understand is used by Victorian Treasury. It is a model that essentially you apply an economic shock to. It is a model that models the whole state economy — you apply the shock and then you see the result. It is well supported and well recognised, obviously being used by Treasury.

The first test was a $200 million investment over five years in a variety of projects. That gave a very positive result to the economy over that period of time. It found that the use of government bonds or debt had the highest effect — developer levies had a considerable slowing of the economy and held jobs back. It found that there were about 500 extra jobs created every year in the economy as a result of that extra investment, and almost 1000 extra jobs in the economy after 14 years — there would be 1000 people more employed at the end of that period. The economy would be $519 million better off for just spending $40 million extra in infrastructure spending using government debt or bonds.

There have been some questions about some of the assumptions being made, so in the report I have supplied to you we have asked Allens to consider some of the main questions; the last pages give some detail as to those. I will not go into them now; you can read them for yourselves.

That gave us the next point which New South Wales had considered: if it is positive for a small project, what happens if you have a very large project or projects? They modelled road and transport projects at $1 billion a year for five years and it really did stunningly show the effect that, firstly, infrastructure spending can have on a state economy and, secondly, how some uses such as special purposes vehicles and government debtor bonds really do have a massive effect on the economy, and some have a slowing effect.

It found in Victoria that all of them in the long run produce a positive result but they take a long time to get there and they hold the economy back in the meantime, whereas bonds and special purpose vehicles move immediately into the positive and continue to grow approximately 1 per cent higher GSP at the end of the period. That gives us such a strong result. I will just go quickly through some of the numbers. Over the 14 year period debt would create $11.6 billion in extra GSP; special purpose vehicles, an extra $10.2 billion. That leads directly to jobs. The opportunity cost of not doing this is calculated in Victoria at about 184 000 jobs if you use just regular state taxation.

The benchmark was assumed to be spending from the state budget, so state taxation. If you just use the current money from the current budget every year, then you get a positive effect in the long run, but it holds the economy back in the short term before building up, whereas if you effectively leverage by borrowing, you bring forward projects that have a positive economic impact on the economy such as major transport projects or other projects directly affecting the economy's growth, and you have a massively improved performance.

The report shows a number of major things. The first is that if the state budget is responsibly used, if fiscal responsibility is maintained, then spending more on productive infrastructure can have a major impact on the state's economy. We asked Allen's to consider the impact of spending $1 billion extra per year on infrastructure through bonds, and it found the current rate of state debt is about 1.1 per cent of GSP — that is predicted in the state budget to grow to 1.4 per cent by 2007 — it would add less than half of 1 per cent to debt as a proportion of GSP. Given that the last time we were anything less than AAA rated we were nearly 3.5 cent, it is significantly below that level. It is suggested that there is a big area that can be utilised.

It is a report that has been received favourably around Australia. It is making an impact. People are starting to reassess whether or not the very tight fiscal responsibility of the last few years is still warranted. There is certainly no doubt that in the early years balance sheets did have to be cleaned up. They contained a lot of useless debt. Debt in the past was used quite often for a current expenditure. We do not propose that. We propose that the only reason to increase your debt levels is for productive economic purposes, and we think the major way to do that is through infrastructure spending.

The CHAIR — We have just one submission, is that correct?

Mr BARTLETT — I thought we would hold off a little bit for the PPPs. Because of what you said about Partnerships Victoria I felt we would do that as a separate part of our presentation.

The CHAIR — Why not do both now and then the questions can cover both?

Mr BARTLETT — Okay. We met with Mr Fitzgerald two or three times in the process. We felt the government did not give him sufficient time to meet all the terms of reference he was asked to consider. There were a number of major issues he did not touch on at all, such as the infrastructure council. He did not look at process issues in any great detail.

The major issue in the industry that I think will probably be borne out by his final report is that the industry believes that process change is an absolute requirement to ensure the future of PPPs in Victoria. Partnerships Victoria has some quite burdensome paper requirements and unless those things are immediately addressed, then the whole policy itself is at risk.

We propose that a reference group should be established, that the terms of reference should be that it has a set period of time to go through every suggested process change and report on whether or not they are useful. We believe there have been about 100 process changes submitted to Mr Fitzgerald and he has suggested that he will not have time to actually go over those in any great detail. That is really not good enough. If he has not got the time to do it, somebody else should.

We propose that this reference group could be established quickly and could be made up of the group of people who made submissions. Only 35 submissions were submitted to Mr Fitzgerald. It is not hard to get a group together from that. They are all quite expert in PPPs. They have dealt with them in Australia and overseas. They are well-respected, nationally significant companies and would certainly be able to add great value to the process.

It seemed to us in the early stages of talking to Mr Fitzgerald that he really had not spoken to industry enough, that government departments were at the top of his list of people to speak with and industry was at the bottom. We took advantage of that and pushed very hard to get as many meetings with him as we could, and we established a couple of reference groups that really put a lot of work into considering some of the process changes. I personally think that our promotion of the report to the industry actually increased the number of submissions he received. As I said earlier, we have a very strong view that infrastructure plays a major part in the economy's health and any industry group that does not consider infrastructure a major issue for it is really a little bit narrow.

We had a few other views about the PPP report, not least the capital asset pricing model that he talked about at length. We have a strong view and agree with the view Treasury just expressed to you. We think it is broadly comparable with international experience, that the level of return actually has to be significant, otherwise the huge costs associated with bidding and maintaining an asset over a 40-odd-year period will not be realised. It increases the risk to government where there is no significant return to the private sector. They are more likely to fail or not go ahead or be handed back.

There are a number of other issues such as the forward pipeline of projects. We agree, but we recognise there may be some risks associated with that and they have to be continually reviewed and realistically assessed and not just a dream group of projects that will never get off the ground. It has to be realistic, otherwise people will increase their resources and they will not come forward. That is the main issue.

Our submission sets out a couple of things. Firstly, it discusses the flaws we see in Mr Fitzgerald's report and the reasons for that. We felt the time lines were the major issue. He was not given sufficient time to deal with the detail. The reports are quite substantial. The Partnerships Victoria policy itself would have taken him a couple of weeks to read.

The second part is that he left out the process change improvements. We felt most of the issues he dealt with could be responded to in process changes. Setting the $100 million limit is really arbitrary when you consider that if you change the whole process, you may actually make projects under $100 million far more viable. It is certainly the case that a PPP costs millions of dollars to bid for. There is a huge risk associated with that. We understand for the cross city tunnel in Sydney there were three bidders and each of the bidders spent approximately $10 million bidding for that project. That sort of cost is extraordinary and it is process driven.

The third issue is that many of the projects are continually going back to best and final offer (BAFO). We believe the government goes back to bidders four and five times asking for changes or tweaking. Process can fix that. One of the things they do in Britain and are now starting to do in New South Wales is they have a set amount of time for a bidder to meet with a client. Currently in Victoria the bidder never meets the client, so how do you develop a good project if you do not actually know what it is they really want. The briefs tend to be quite thin on detail, long on waffle, and unless there is a significant change there where the bidder and the client have a chance to get together, then you maximise the bidding costs because you almost invariably go to the BAFO process at the end.

Small projects have been shown in Britain and other countries to be significant and to work well. Small projects which have been aggregated — schools, hospitals and things like that — have worked well in other countries so there is no reason why they cannot work well here. They do not have to be purely of a technical nature because one of the things Mr Fitzgerald suggests and shows quite clearly is that PPPs have a very strong result in terms of on time and on budget. They almost invariably come in on time and on budget, and that cannot always be said of traditionally procured government projects.

They are the main points we have about that. We are hoping that Mr Fitzgerald's report responds to the issues raised in the submissions made by most of the submitters. We hope that coming out of that report he will suggest further process review.

The CHAIR — My first question relates to your government debtor bonds. From what you have said, and not having read your Allen Consulting Group paper because it has just been handed to the committee members, you are as much concerned about infrastructure projects in the pipeline as the method of procurement for government. You are more concerned about the fact that we need infrastructure in this country and in this state, and that is your primary concern. Have I picked that up correctly?

Mr BARTLETT — I think that is the premise. You have to consider what is the infrastructure need in Australia. It is acute.

The CHAIR — Further on in your submission you made the point that if we go down the path of PPPs, the level of return has to be significant as opposed to, say, the traditional procurement because the risks are so much greater. Have you got a ball park figure for what you believe would be an appropriate significant return in, say, a PPP project compared with a traditional procurement of an identical piece of infrastructure?

Mr BARTLETT — I do not want to give a set percentage, but generally the industry feels quite comfortable with where it is at the present. It is an immature market; there have only been eight projects currently in Victoria. Given that Victoria's rating, as Treasury said earlier, is similar to that of Britain, it seems internationally comparable and appropriate. There appears to be a limited number of players in the market at present but we feel that is because of the bidder costs, that only significant companies can come forward.

Perhaps Bernard can talk on that point, because many of the projects and companies that would like to get into them hold back simply because the costs are so excessive. That is why we see there is a limitation on the market, not because of the returns. The returns are probably appropriate at the moment. The market has worked through them and got to this point. If they return to some of the suggestions of Mr Fitzgerald, which included long-term bond rates and what have you, we do not feel that is sufficient and the industry does not feel that is sufficient. We feel that would narrow the market even further and make them virtually unviable. Perhaps Bernard can talk about smaller projects.

Mr McNAMARA — The simple answer is we determine the risk on the project and the return has to measure up. We are not in the infrastructure business as such but there have been a couple of instances recently particularly to do with transit cities where we are undertaking a number of projects at the moment. One of those is at Frankston, which the minister has now announced is being proceeded with, which involves government infrastructure assisting with a project that otherwise would not happen.

That was only a small amount of money, but the transit city fund, for example, is about a $10 million amount in the government budget, which, given the expectations of Melbourne 2030, will not go anywhere because we will use $2.7 million over two years, which is underpinning some works which otherwise would not have happened. The Gandel Retail Trust, I think, is investing $130 million in two projects.

The government transition funding unlocked that problem we had around the site in terms of providing infrastructure. That is just a government payment. It does not involve public-private partnerships (PPPs), but I can see going forward that if there is a seriousness about the policy there will be a need for either the advancement of government funds or a movement towards lower or simpler versions of public-private partnerships, and none of the processes we see here would be suitable for those because the bidding costs, the allocation of risk and those sorts of things just make them unmanageable at that level. We are talking maybe $100 million, $50 million or $20 million projects, but the processes involved in that, as occurred in our case, are prohibitive.

We had a strategic value in there because we had investments down through it all, but the City of Frankston used a process which it borrowed from the Docklands. We found that a very difficult and very expensive process for us to go through. That experience in public-private partnerships told us that we should be very wary about going into other ones unless we got a really strong strategic vested interest there, which we did have in that case, but that situation for a bit of land worth $8 million cost the Frankston City Council in excess of $1 million and it cost us in excess of $1 million. That was totally out of proportion for what it was on the face of it.

Unfortunately when you get into these processes they run themselves; they run out of control because various probity requirements and legal things come in. I am sure the bidders in Sydney never realised that they would be going that far, but when you get in that deep you cannot get out, and that is the problem. Therefore you make a decision very early on about whether you go in.

This is not an example, but we made the decision at the end of the day not to proceed in becoming part of the Point Cook town centre investment. That was a VicUrban project. We had successfully built Roxburgh Park shopping centre on a VicUrban project some years ago, so we had worked with VicUrban successfully. But we made a decision not to proceed with Point Cook when we assessed that the process that was going to be involved, in our view on the basis of return, would not justify us proceeding on that basis. It involved some of the things we do on a core basis: building retail and residential in a combined development.

Mr FORWOOD — Are you saying that your assessment of transaction costs stopped you from proceeding?

Mr McNAMARA — Yes, because in that situation our initial assessment was that the outcome that was being looked at was such that we believed the land was worth nothing, because in terms of the type of infrastructure required, including all the roads, main drains and sewers, we believed building up the social infrastructure in that town centre was a very expensive process. In that situation there must be a way you can actually say to VicUrban, 'We will have an open book with you. Here is our minimum return that we need for the project. There are our costs; we will work it out for you, and we will work our way through'.

Unfortunately the processes do not allow for VicUrban to do that, and yet the bidder is the one that has to hold their breath and go into a process knowing full well that he is not sure he will be coming out the other side. So we assessed the bidding processes at that time. I would say they were not going to be huge amounts — this was a smaller scale project — but we thought at the first stage the process cost would be in excess of $100 000 and then it would go on from there. I am saying that at that level we were not comfortable that we were going to get a return, so therefore we just dropped out of it. Somebody else may, but we made that decision as a company.

Mr BARTLETT — This is important because this was a relatively small project. It is the sort of project that needs to go ahead, but it is also an example of where market size of PPPs is being held back, where only the biggest players get to go into PPPs, because they are the only ones that can afford to take on the huge risk. If you decide to limit the market to projects of $100 million or more simply because of process, you are limiting the policies opportunity massively. If you reform processes and costs a whole new range of projects can come forward and a whole new set of ideas, and you massively increase the number of players in the market and the number of companies able to bid and come forward for projects.

The CHAIR — Mr McNamara, the question I asked Mr Bartlett related to what business considers a fair rate of return, and you referred in regard to Point Cook to what you considered a possible way forward, and that was the open-book process where you would actually put what you expected as your rate of return. That is one company. Is that consistent with what you believe other companies would do — put their rate of return out there?

Mr McNAMARA — Ours is out there — the Colonial First State Gandel Retail Trust is a publicly listed trust. If you invest in that we offer you a consistent return. If we can provide and achieve that, including the costs of management, then we will do it, provided we can identify what the risk associated with the project is. We would have a capitalisation rate for a project, be it a core centre, but the capitalisation rate or the valuation rate for a mixed town centre or a bridge — I am not expert in that, but I am sure people can do that. But effectively, going back to your question, that is the rate of return. I am sure City Link has return rates in its prospectus and reports.

Mr MERLINO — Can you give a few examples of some of the core process changes that you are talking about?

Mr BARTLETT — I just refer you to page 14 of the submission that we have provided today. Dot point 3 refers to standardised approaches. At the moment there have been 8, I believe, in Victoria, with 8 different sets of contracts, 8 different sets of processes, 8 different departments, no standardisation or consistency, changes along the way, and no standard contracts. That massively increases the costs for government. Every time you do it you are reinventing the wheel. The government needs to standardise its approaches as a priority. They do it in Britain and it is working successfully there. I know most of the people making submissions to Mr Fitzgerald suggested that.

That is where dot point 5 comes in, which suggests a single government office, is a major priority as well. At the moment I think Major Projects Victoria is starting to get more and more involved in these projects. We feel that is a good step forward, but we believe a specialist office should be created where possible.

Mr FORWOOD — Aside from or within Major Projects Victoria?

Mr BARTLETT — The positioning is for government, but we believe a specialist team should be managing the whole process from day one. Project risk is important, and it does need to be assessed in a realistic way. The general line is to consider the projects hire-purchase agreements — that is one of the best ways to think about PPPs. It is always going to be inherently more risky, but in a lot of these cases they are projects that may not have gone ahead without private sector involvement. So the government has to realise it is getting a significant improvement to the economy for spending that it is not capable of funding itself. So there is that aspect.

Also, as the next dot point explains, we need an idea-driven environment, which is where more and more people start to think about the possible infrastructure projects that are available, where you have a culture that encourages the private sector, the PPP office and the government to work together to identify projects. At the moment I think there is a little bit of a bunker mentality — who knows where the projects really come from, where their genesis is? But we need a bit more of an idea-driven environment, and perhaps a new PPP office, a reference group, the infrastructure council and what have you — all those things — can help Victoria identify its needs.

We are of the view that projects such as the Dynon port rail link, which is often called Melbourne Portal, are the sorts of projects that need to go ahead as a priority. We saw a press release last week where the state government was asking for federal assistance on that. We support that. We would like the federal government to support that project, but we do not see that that project should be held back simply waiting for the funds to come from recurrent expenditure. That is the sort of project that could massively add to the state's bottom line and should be proceeded with as a priority.

Mr FORWOOD — As a PPP or as a debt-funded project?

Mr BARTLETT — There may be PPP opportunities within it; no doubt the companies that are involved down on the wharves would be interested in PPPs, but that is to be determined. We believe every project should be assessed on its merits for a PPP; you should not just assume a dollar amount sets a PPP rate.

Mr CLARK — You mentioned the Infrastructure Planning Council, which, of course, reported sometime ago. So far as I am aware not a lot has happened with it since. Does the Property Council of Australia have views about how the process of infrastructure planning and placing into the pipeline in Victoria is operating, and do you think there are things that could be done that would lead to better results for government and also make it easier for the private sector to participate?

Mr McNAMARA — We have to say that the Infrastructure Planning Council just seemed to stop. In our view when the Infrastructure Planning Council report appeared there was a gap, there was a government response and then there have been bits and pieces in terms of budgetary announcements, but from the point of view of momentum and getting people behind infrastructure development in Victoria, the thing has been dropped. In our view we would like to see that becoming far more of a focus of discussion between the government and the community as to what happens. We see bits and pieces coming out now, but it seems to me that the framework is lost in terms of the need to produce these things and go forward. I say that about the infrastructure issues.

We have in our policy platform quite a number of infrastructure items we see as important and essential. Mr Bartlett mentioned one of them, the rail port. We have a view that that should go forward, but certainly the Infrastructure Planning Council, while it as useful at the time, needs to be freshened up and to be now thought through again. I would have thought there was quite a lot of value in a government, community or business engagement on that basis.

Mr BARTLETT — The general feeling was that the report itself was strong, that it did contain a number of good initiatives and that it was worth while following up. But there have been fits and starts since then. It could well continue as a bit of a think tank and a bit of an ideas base, and that has not necessarily happened.

Mr DONNELLAN — Did the council look at federal taxes and so forth with regard to encouraging more players in the provision of private sector infrastructure? I note that in its report Allen Consultants said that development levies were the least desirable way of funding infrastructure. That is fair enough. What was the way forward? What would you see developers contributing in the marketplace vis-a-vis infrastructure, or are you really saying that making some contribution to infrastructure in the community is really not a market for the property market developers to be involved in?

Mr McNAMARA — May I answer the second part of the question first? Traditionally developments have always provided substantial infrastructure, and that has been the case be it subdivision or headworks contributions. There has always been a very clear responsibility on developers to do that.

What has happened over the past few years has been this introduction of a number of things called, for want of better words, development contributions, levies taxes, or whatever, and they have been very unevenly applied. The various state government groups have tried to come to terms with those. But they have been applied in new estates as per lot requirements — and that is getting quite expensive in some municipalities now. They relate to various matters of social infrastructure, park development or bits and pieces like that, and they are all done in good faith by local government authorities in the main, that have had a problem with the infrastructure shortfall, and that has been because of the funding pressure and their own borrowing limitations.

But they have had major issues in terms of distorting the market — a very uneven application. They are probably responsible for pushing the price of established housing up; the base has been lifted out there because there is quite a bit of flow on, and you encourage avoidance behaviour by developers to try and avoid what they might see as standard arrangements. Sometimes the nexus between these is very hard to understand. I am not saying that there should not be some sort of development contribution, and there is, but it seems to be that it is overly relied upon and the evidence that is coming out is that it has a negative impact because people are trying to avoid it or minimise the exposure. On the first point, Robert might want to talk about the federal role.

Mr BARTLETT — In relation to the federal taxes environment, I would have to say that I am not across the detail of our submission. Obviously there are a considerable number of suggestions to the federal government in relation to the tax treatment of some of these projects and I can certainly ensure that you get the details of that.

Mr McNAMARA — But the short answer would be that we think the federal government's approach to taxation is a bit severe. There has been a history of issues where the taxation system probably prevented some innovative projects going ahead, and the fast rail is probably the one that stands out — it was dropped because they could not get an acceleration of taxation treatment. I think sometimes with those things you need to be a bit more lateral.

Mr RICH-PHILLIPS — The Allen report shows that government debt is the best form of financing on the criteria in the report followed closely by special purpose vehicles. If the changes that you have mentioned in your submission are made to the PPP mechanism — and I have to say that those are changes that a lot of witnesses have said are needed — have you done any modelling that shows how SPVs would then compare to government debt given it is a relatively small margin between the two on those criteria?

Mr BARTLETT — I think there is an assumption in there of the inherent costs of PPPs and it may be that there is a change in the outcome, but the modelling has not been carried out. Given that is a bit of a grey area, I am not quite sure what the changes would be. I think it would be difficult to quantify. I think the strong point though is that they obviously have a strong effect on the economy.

Ms GREEN — This is not so much a question, but a comment. In terms of some of your recommendations — and I think they are good — —

The CHAIR — Recommendations to Fitzgerald.

Ms GREEN — Yes, sorry, to Fitzgerald, but in terms of the evidence that we took in the United Kingdom that — I think it was KPMG who said to us that they felt there was still no decrease in transaction costs despite the recommendations that you have shown here and that have been implemented in the UK. They felt there was just an increase in complexity in that marketplace. I would not necessarily — —

Mr FORWOOD — Don't hold your breath!

Mr BARTLETT — The players here would like to get the opportunity to find out.

Ms ROMANES — Are there any practices in New South Wales that Victoria should be learning from?

Mr BARTLETT — I am very well aware that New South Wales has moved to have bidders and clients meeting already; they have started that process and the early mail is that it is working quite well. When they are getting five and six BAFOS, it is just such an obvious improvement.

Mr FORWOOD — Does the probity auditor sit in?

Mr BARTLETT — Probity auditors are constant.

Mr FORWOOD — So they sit in on the meetings?

Mr BARTLETT — They are there all the time. It is a very strong process.

Mr CLARK — Do you regard it as an impediment that they are excessively zealous in some instances?

Mr BARTLETT — I think it depends on the individual probity auditor's approach.

The CHAIR — The fact is that we live in a political environment.

Mr DONNELLAN — You talked about New South Wales and the Allen report. Is there one plot per developer in certain areas?

Mr McNAMARA — They have had a longer history there through developer contribution plans and it had to be through a plan to get a levy to stick. That has now been introduced in Victoria, but now a default levy has come in because people have found it too hard to get their plans through; the government has agreed to a default levy so now there can be a levy in place at a level for blocks of land. If you are in the City of Stonnington, for example, and you want to have a developer contribution levy for infrastructure upgrades in the drains, then they would have to bring in a plan. The problem at the moment is that they get the big guys, but for everyone else it is four units. No-one else ever gets that. It is normally a very uneven situation.

Mr FORWOOD — [inaudible]

The CHAIR — Not necessarily, I am not allowing that to happen. There are too many things that we asked about overseas that I want to get an Australian perspective on. In terms of refinancing we heard evidence, again overseas, that governments are now expecting a higher proportion, and in some cases it is the first time they have ever asked for a percentage of the benefits of refinancing. Has your organisation or any particular business any comments on the benefits of refinancing?

Mr BARTLETT — That is a matter for the bidders as they enter the contract process, but as long as it is accepted and well defined from the beginning, where they can anticipate the risk of refinancing or the costs associated with the matters, then I am sure that bidders will feel is appropriate where there is transparency. It is where matters are changed somewhat ad hoc later on that they would have a concern.

Mr McNAMARA — Should it not depend on who has got the finance risk?

Mr FORWOOD — Yes.

Ms ROMANES — But it is about sharing windfall gains.

Mr McNAMARA — If it is a partnership and you are both sharing the risk then you should both get the benefits.

Mr FORWOOD — That is true, but if there is a windfall gain made through the refinancing of a project once the major risk has been overcome, should you not then share that with government?

Mr McNAMARA — Maybe you should. However, if you had a problem on the way through, would the government come in and prop you up? The risk has to be rewarded or paid for. So often you can enter these contracts and things go against you. I do not think the government is going to come in and help you.

Mr FORWOOD — So basically you want to keep the windfall.

Mr McNAMARA — I am saying that it should follow the risk, but if it can be written in and people are happy in the circumstances that that applies. I think Robert is right, if it is written in at the start then they can price it.

The CHAIR — In terms of project specifications, has it been your experience that from the commencement of traditional procurement to the signing of the contract and the commencement of a project under PPP and the signing of a contract that one is any better than another for the private sector?

Mr BARTLETT — The British report said that very clearly and I think that Mr Fitzgerald's recommendation analysing the current procurement practices against PPPs here would probably come up with the same result. That tends to be the feeling from the industry. PPPs have a strong record of being on time and on budget and that is because it is in the interests of the partner, which is the private sector partner, to get it on time and on budget, whereas traditional procurement has a well-established record of changing quite regularly along the way.

The CHAIR — My last question relates to transparency and accountability. There has been significant debate about what government is prepared to put on the Internet and what business is prepared to put on the Internet. As an organisation have you got any comments on the level of transparency expected in Australia and in Victoria?

Mr McNAMARA — During the bidding process?

The CHAIR — Afterwards. I understand intellectual property.

Mr FORWOOD — Once the deal is done, what information should then become available to the public at large?

The CHAIR — Is it in your submission?

Mr BARTLETT — We have certainly referred to it in the submission. My memory of it is that most of the industry does not have a problem with it.

Mr DONNELLAN — We got the D minus compared to others in terms of infrastructure?

Mr BARTLETT — That was Australia-wide. They did a New South Wales study that just focused on key aspects such as water and what have you and then they did an Australia-wide one and it came up with a D minus — —

Mr DONNELLAN — Overall?

Mr BARTLETT — Overall. The stories that I referred to earlier, including the wooden country bridges, are the sorts of projects that could never ever be a PPP but are in some cases vital for a community's economic health.

The CHAIR — Thank you, Mr Bartlett and Mr McNamara, for making your time available. I hope your health improves, Mr Bartlett. You will be provided with a copy of the transcript very shortly and any follow-up questions we will direct to Mr Bartlett for your consideration.

Witnesses withdrew.

CORRECTED TRANSCRIPT

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Private Sector Investment in Public Infrastructure Subcommittee

Inquiry into private sector investment in public infrastructure

Melbourne – 27 January 2004

Members

Mr W. R. Baxter
Ms C. M. Campbell
Mr R. W. Clark
Mr L. A. Donnellan
Mr B. Forwood
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Witness

Mr P. Oppenheim, Managing Director and Head of Infrastructure Capital, ABN Amro

The CHAIR — I welcome Paul Oppenheim, the managing director and head of infrastructure capital for ABN Amro. This is a public hearing on private sector investment in public infrastructure. All evidence taken by this subcommittee is taken under the provisions of the Parliamentary Committees Act and is protected from judicial review. However, any comments made outside the precincts of this hearing are not protected by parliamentary privilege. All evidence taken today is being recorded, and you will be given a copy of the transcript very shortly. It will be a proof version, so feel free to correct any typographical errors.

This is the subcommittee's final hearing, so we thought it would be very useful to have your comments on the initial Peter Fitzgerald report on the review of Partnerships Victoria provided infrastructure, and particularly on the capital asset pricing model. Then there will be a number of specific questions we want to put to you. If you would like to make some opening comments, please feel free to do so.

Mr OPPENHEIM — Thank you very much for the opportunity to talk to you and to talk a little bit about some of the deals that we have been involved in. I am happy to answer any questions on anything that we are involved with in Victoria and the way we go about approaching PPP transactions.

In terms of the Fitzgerald report itself, we responded formally to it. To summarise our views on it, we thought it certainly made some good recommendations in a few areas. I think in some ways we were also disappointed at the amount and the depth of the analysis, specifically in relation to some transactions that have occurred. We felt there could have been a bit more detailed analysis of the risks and the way the tender processes were conducted, and a bit more in-depth analysis of the benefits or otherwise of specific transactions to the state.

Whilst we agreed with a number of the recommendations, we thought the report did not drill down deep enough into the real contractual structures and some of the risk allocations that the process delivers for the state.

In terms of the capital asset pricing model (CAPM) and the discussion on that, our view is that it is a very technical area where some recommendations were made, but not with a full analysis of why it is done in a particular way. It is done slightly differently in the United Kingdom. Overall we did not specifically agree with that recommendation. We think that the current approach, while subject to refinements — and it has been through a first round of refinements — is probably more appropriate, although because it is such a technical area there are arguments to be made either way. But overall we thought that having a CAPM-style approach is probably more appropriate on balance notwithstanding that there probably can be some refinements to how the discount rate per se is derived from individual projects.

The CHAIR — Thank you very much. I want to go to the issue of the rate of return. I am not sure if you, Mr Oppenheim, were able to hear some of the evidence of the previous witnesses.

Mr FORWOOD — No, he came in just afterwards.

The CHAIR — Representatives from business have said that for the transfer of risk they need an appropriate rate of return. Do you have any ballpark figures on a range of projects that you think would be an appropriate rate of return?

Mr OPPENHEIM — For a private-sector consortium funding a specific piece of infrastructure?

The CHAIR — You can give us hypotheticals; I am not asking for specifics.

Mr OPPENHEIM — The somewhat glib answer to that is that it is very much on a project-by-project basis. Very different risks are brought into different sorts of projects. Something like Spencer Street station has genuine equity risks and a range of third-party income streams which are much more akin to equity, so it is a lot more volatile and difficult to forecast.

When you look at the overall cost of capital to the consortium, we are valuing the payment stream from the state very aggressively, but then the cost of capital for the whole consortium is pushed up by the fact that in that particular deal there is a range of third-party income streams ranging from advertising through to retail and baggage lockers and those sorts of things.

The cost of capital is pushed up in that transaction so that the return to the private sector needs to be balanced in what payment stream it is receiving from the state versus what risks it is taking outside of payments streams that issue from the state. The cost of capital in that transaction is higher than it is for something like Berwick hospital, which is a much simpler transaction where the primary source of income is a payment stream and availability payment stream from the state, and where there are only incidental revenue streams available to the private sector.

That is the sort of subsidy that the private sector brings to something like Spencer Street where we have valued all of those third-party income streams and been able to raise additional capital not dependent on the state's payment stream quite a bit higher. Although that is a somewhat roundabout way of answering, in a very simple transaction like Berwick where car parking revenue is the main additional revenue stream versus Spencer Street which has a more complex and a heap of non-government dependent revenue streams the cost of capital is a fair bit higher. I would say that the general range is probably about 100 or 150 basis points over the state's debt rate.

But when you get into more complex deals like Spencer Street you have a whole bunch of commercial development and other revenue streams which are removed from the state. If you looked at the cost of capital in that transaction, it is a reasonable amount higher because there is a lot more equity risk to it, to put it in simple terms.

Mr CLARK — To follow on with the Spencer Street example about the cost of capital, could it not be argued that a lot of the additional risks that you referred to are no business of the state, that these are property development opportunities which are quite free standing from the state's primary objective of having a functional railway station? Therefore, why is it that the state should pay a premium for that risk? Is it simply that the state is giving a concession for this private property development in order to reduce its total cost to budget?

Mr OPPENHEIM — That is exactly what is happening — the state is not paying a premium. The state's payment stream is sized purely on what is required to service an element of the capital. The remainder of the capital is forecast to be serviced by these third-party revenue streams which are, as you say, nothing to do with the state. It is a bit of a misconception to think that the state is paying the premium — essentially that the private sector is asking for a premium but is reliant on non-government revenue streams to realise that higher rate of return. If those revenue streams do not come to be or are not as high as they forecast, the return will be very low.

Mr CLARK — So, for example, when the changes to the project design were made a few months ago and some of the commercial property aspects were, I gather, scaled down does it follow from your previous answer that that scaling down did not have any impact on the state or on the cash flow the state had to pay?

Mr OPPENHEIM — It had no effect.

Mr CLARK — It was one of the commercial risks that affected the commercial side of the project.

Mr OPPENHEIM — It was a commercial risk and the downscaling of it was a commercial decision based on changes to the property market and the way the property market is now versus when we bid. That is part of the risk we took on and that is exactly what occurred. There was no change to the state's deal. Obviously we had to go through a planning process but apart from that the actual economics of the arrangements between us and the state did not change significantly around that.

Ms ROMANES — The Fitzgerald report has suggested that there could be more transparency and accountability in the way Partnerships Victoria manages the PPP projects and has suggested a forecast payment schedule so it would be out there in the open how much money the government is paying over a period of time to different projects. Do you have a view of that proposal?

Mr OPPENHEIM — I do not think we would have an issue per se with the government's payment stream being disclosed if that is what the state wanted to do. We will obviously always seek to keep the documents on our side of the fence so to speak — the private consortium arrangements and the payment streams among the various consortium parties and the way the consortium is structured — as commercial in confidence. But the way the state seeks to present itself and its contracts, I do not think we have any problem if the state wants to go further, if you like, in whatever it does.

Mr FORWOOD — You have done a lot of this stuff now. You have probably done more than anyone else in Australia, I guess.

Mr OPPENHEIM — We have had a reasonable role.

Mr FORWOOD — You are producing some new fund to move into social infrastructure, aren't you? Could you just run through how it works and what you plan to do with it?

Mr OPPENHEIM — The rationale behind that is we have always been a financial underwriter and looked to sell down the projects to appropriate investors at appropriate points, often closer to when the project is more finalised as construction is completed. Once we have all the risk out of the way we then look to package it and sell it. What we have recognised is that for the state it is important to know who is going to be the long-term private investor in social infrastructure assets.

We identified a party we thought would be a very good fit for that being DAF, which is the Development Australia Fund, who run a number of infrastructure funds and primarily have industry superannuation investors investing in those funds. We saw that they did not have a sort of social infrastructure leg or arm to their funds management, so what we proposed to them was entering into a strategic arrangement whereby we would set up a social infrastructure fund, which was set up late last year, and we have put a number of assets into that social infrastructure fund.

Mr FORWOOD — Like?

Mr OPPENHEIM — Wyuna Water, which is a New South Wales deal; New South Wales schools, which was one of the first PPPs done with New South Wales; and a portion of Spencer Street station. We have looked to put 75 per cent of the equity in Spencer Street station into that fund.

It has basically been set up to take assets where we are successful, so they will effectively be part of our consortium — a bidding partner with us — such that for new hospital and social infrastructure-type assets we will be able to present the long-term equity investor which will be this social infrastructure fund which has as its investors a range of half a dozen-plus industry superannuation funds. It is the likes of CBUS and Hesta and those sorts of funds.

Mr FORWOOD — How big is it?

Mr OPPENHEIM — It is currently in the order of $250 million, and we are looking to keep growing it over the next couple of years; we hope to double it.

Mr FORWOOD — But you will grow it according to the projects that you are able to put into it?

Mr OPPENHEIM — That is right. We expect that there will hopefully be an annual capital raising into the fund, and hopefully there will be a steady stream of projects firstly out of the various states but ultimately we need to be successful.

Mr FORWOOD — Just to get this clear: does the capital raising come before you get the projects or after you get the projects?

Mr OPPENHEIM — The initial capital raising is done and there is spare capacity in the order of, I think, about $60 million to $70 million of excess capacity, uninvested capital. It is a little bit fluid, and we will need to manage it; you do not want to raise it and not have the projects, and equally you do not want to be on the hook for a project and not have the money. That said, ABN Amro will always be there as the backstop, always there as the underwriter so it is only a timing thing.

Mr FORWOOD — So you will underwrite it and settle down?

Mr OPPENHEIM — We will still continue to underwrite it so the state still gets absolute certainty that the funding will be there notwithstanding that the fundraising may not have occurred yet in the social infrastructure fund — ABN Amro will always be there.

Mr FORWOOD — My final question: is there some sort of hurdle rate that you need to get over in order to get into the fund?

Mr OPPENHEIM — The fund does have a range of criteria in terms of returns that it expects. It has a minimum of a 9 per cent return. That is on a geared basis so the debt will be raised at something less than that and then in equity we will be looking to get at least 9 per cent. Of course every project will be based on its risks and returns and on its merits. That is the benchmark, if you like. There are some other criteria around it but that is the headline number.

Mr FORWOOD — Sounds very good.

Mr OPPENHEIM — We think it is a good source of capital for these sorts of assets.

Mr MERLINO — The Property Council was very keen to see some process changes implemented in PPPs. They talked about things like a specialist team or a specialist office to deal with PPPs rather than going through eight different departments, eight sets of documents et cetera. Does ABN Amro have a view about that and also any other process changes that you would like to see implemented in regard to how PPPs operate?

Mr OPPENHEIM — On that particular point we have a view that whether it sits within Treasury or not, there does need to be a central agency that guides these transactions. To really make them work you need a strong driver — whether it is inside or outside Treasury does not matter. It is currently inside Treasury and that seems to work reasonably well.

To take it completely out and distance the line agencies would be very problematic because as part of their planning processes the line agencies are going to be very close to determining which assets are the priority and which assets need to be funded however they are funded, whether it is through PPPs or not. We think it works reasonably well in the current model.

As I say, the Treasury team and whether it sits in Treasury or not is probably a separate question but I think the model of having a strong central agency to drive it and to bring the line agencies along and do it in cooperation with the line agencies is the better way to go. We have seen in other states where it is driven more by a particular line agency that projects are a lot more problematic.

Mr MERLINO — Any other process changes that you want to touch on?

Mr OPPENHEIM — We obviously think the process works reasonably well.

Mr FORWOOD — You would.

Mr OPPENHEIM — If it ain't broke don't fix it! I think in fairness one of the areas which the state has started to try to address is the whole design question. It is a real challenge in these output-based specifications — where the specification is very much output-driven you can end up with some very different designs. That means you may end up with a design where everything else about the proposal is very good — the financing is very good, the construction is good and everything — but the design for whatever reason is lousy and unworkable.

The state is not so much taking the design risk out of it, but, as a part of the process, being a little bit more interactive in the design. I know the state has started to look at that. It can be beneficial for the state to ensure it does not have to throw out one of the bids because the design is way off the pace.

Mr BAXTER — We have heard evidence in a number of places about the level of transaction costs. They appear to be high and in some cases out of proportion to the total cost of the project. From ABN Amro's worldwide experience how are transaction costs in Victoria? Are they similar or are we out of line to some extent, one way or another?

Mr OPPENHEIM — I think in our experience — we have just started up and been operating for a couple of years in Canada and the UK — bid costs are probably marginally higher in Victoria but I think something the Victorian model should not lose sight of is that it has a huge advantage, particularly over the UK model, whereby the reasons the costs are probably higher is the Victorian process does drive a lot more certainty into the transaction for government.

In our experience government has pushed really hard to ensure that when it announces a preferred bidder it absolutely knows the deal it is going to get, there has been a lot of work on the design, there has been a lot of work on the contractual structure and there has been a lot of certainty driven into the process. That has an on-cost to it but while the market is there and while the bidders are there, it is a huge advantage.

As sort of an example, the UK runs through a very quick process of expression of interest — they have different terms — and then a tender process but once they select preferred, to get to contractual or financial close takes on average 12 to 18 months. Just knowing the processes, the deal the government thought it was getting and what they finally got there has to be some movement over a 12 to 18-month period.

In contrast, in the two most recent ones we have been involved in — Spencer Street and Berwick — the tender process continued all the way and the amount of time from being selected to contractual close was about 10 days or two weeks for Berwick. In Spencer Street it was two months but that was a lot more complex. The amount of certainty that the state drives into the process here, while it does pick up the bid cost, is in our view a significant advantage for the state because the market is keen and there probably are not so many deals as there are in the UK. The UK has had to go down that path because they have had 400 or 500 projects and have had to speed up the process and keep the costs down.

In Victoria one of the reasons in our view for some of the successes like the County Court has been that the state has put so much certainty into its tender process. That could be given away if there is a temptation to bring the bid costs right back. I think the private sector has overblown the bid costs a little bit. There are costs and they are pretty significant, but I think it has been overblown a little bit. The state needs to make a balanced choice as to whether they want to look to scale back costs when the price of that will be a reduction in certainty of outcome for the state.

Mr DONNELLAN — What could the federal government do to improve the number of players in the market? There are taxes and things like that. Have you looked at that and are you lobbying as groups or through involvement in committees for that?

Mr OPPENHEIM — We have certainly been active on the tax front in terms of sections 51AD and 16D and the introduction of division 250. We have a tax adviser who we ask to dedicate a fair bit of time to advising the government how we would like to see the tax arrangements change. However, in our mind the tax arrangements are more annoying than a real dampener on projects. With things like 51AD you always structure to get around it. You have to because it is so draconian — I would be surprised if they have ever raised a dollar out of 51AD because it is so onerous and difficult that everybody has to get around it.

You probably add a little bit to the structuring costs, add a little bit to the cost of capital, add a little bit to everything to overcome it, but you always make sure you overcome it. The extent they simplify that and finally get division 250 in and repeal section 51AD will give everybody a lot more certainty and will allow us to reduce some of the costs that go with all the tax structuring that is needed to overcome them.

As to what they could do on the transaction front, we would most like to see them actively embrace the procurement method as an alternative procurement method. The way the various state governments have geared it up, it is only a small percentage of projects that are ever procured that way, but we would like to see them embrace it as well so it is not just a state thing, for the federal government to embrace it and use it as a procurement methodology as the states do.

The CHAIR — If you have any further information you would like to provide about what the Victorian government can do to facilitate changes at a federal level, the committee would be interested in having that perhaps from your adviser.

Mr RICH-PHILLIPS — The committee has a copy of the handout regarding the New South Wales schools project. One of the comments on the tender process is a reference to probity concerns severely restricting tenderers' access to government. Can you expand on what the firm meant by that?

Mr OPPENHEIM — I am not close enough to the specific example. That is our presentation?

Mr RICH-PHILLIPS — That is my understanding, yes.

Mr OPPENHEIM — I think it is a sort of comparison between New South Wales and Victoria. New South Wales obviously has ICAC and it seems very probity concerned. We noticed in a range of different examples that generally Victorian processes have been more engaging, have tried to eliminate some of those design issues and sort of interact with bidders, obviously on a level playing field basis, but engaging a bit more during the tender process, whereas New South Wales in general does not engage with the tenderers at all. You virtually have no face-to-face meetings with anybody to do with government who has anything to do with the project, so everything is done very formally by correspondence and the like. You would never go and show your design through a tender process.

I am not sure what the specific comment was referring to, but I know there is a general difference in terms of probity concern in that Victoria seems to be more willing to accept probity as something that is very important, but equally the government needs to balance the need to get an interactive tender process to drive a better result, whereas New South Wales will rest more on the process and will give greater emphasis to probity and therefore will not allow interaction at all between bidders and the government on a face-to-face basis.

Mr RICH-PHILLIPS — There was criticism in evidence earlier this morning about the way the probity auditor process interacts in the Victorian system and limiting that access, but ABN is quite happy with Victoria?

Mr OPPENHEIM — We think Victoria, particularly in comparison with New South Wales, actually allows better access and better interaction with the government's project team than is allowed in New South Wales. Generally we would not have that concern.

Ms GREEN — You referred to the design issue and that it can be quite complex. The committee heard in overseas jurisdictions that sometimes there was an actual tender process for the design and then there was sort of like a payment made for intellectual property and then again a tendering process. Do you think that would be useful in the Victorian situation, particularly given other evidence that we heard this morning complaining about the bidding process costs?

Mr OPPENHEIM — With everything there is a trade-off. There is some merit to that sort of idea. The trade-off will always be that government is looking to transfer a lot of risk in this PPP process. There is the extent to which a design process is run and a preferred design produced. Then there is the opportunity to bid on that design, but there is the question of all the fit for purpose and the warranties that the private sector is obliged to give when they have designed it themselves as opposed to saying, 'Here is what we want in terms of design'. There is a risk that some of the risk transfer will be pushed back to government: 'That is your design. If it does not work it is your problem'.

The other side of it is what occurs within a consortium. The sorts of consortium dynamics when you have a design, a construction and a finance element to it is that there is a lot more whole-of-life analysis that goes on within the consortium, and to the extent that the construction company is driving in one direction, the finance, maintenance and equity might be pulling back and saying, 'Well, that might be a nice cheap solution, but we will pay for that over the longer term'. There is a lot more dynamic, if you like, within the consortium, given you have to have a 30-year-term focus on things. I think you might lose a little bit of that as well if you ran the design process in isolation from that whole-of-life analysis.

Ms ROMANES — I have a question about refinancing. In the United Kingdom the committee heard evidence which suggested in some cases, mainly from refinancing, there had been some windfall profits related to particular projects, and there had been agreement in some contracts to share any such profits. Do you have a view on the bidder and the government sharing any windfall profits?

Mr OPPENHEIM — To the extent they are genuinely windfall I think that is appropriate. What often happens though is it is not so much windfall profits that are discussed. If everything goes right for the private sector then there should be a payment back to the state. But obviously it does not work in reverse; if things do not go well for the private sector there is not the opportunity to say, 'We have had a windfall loss, can we have some money back?'.

The CHAIR — Perhaps not, in that the government ends up bailing out companies in a couple of examples.

Mr OPPENHEIM — That becomes a policy question.

Ms ROMANES — It is all about public perceptions too, is it not?

Mr OPPENHEIM — It is, and where they are genuinely windfall I think there is a case for them. Where it is more, 'We will share the upside, but we do not want any of the downside' — and I take your point that there are times when government for policy reasons might say it has no contractual or moral obligation to do anything about it, but it might do it for some other reason. That does occur and that will ultimately be the test for the state in future years. If something goes wrong is it willing to say, 'You had the upside, now you wear the downside; we will not bail you out'? I think where it is genuine windfall there is a case, but if there is genuine risk transfer, if it goes good, then well and good, but if it goes bad the state should stand firm and say, 'It has gone bad, you wear it'.

Mr CLARK — I refer to the New South Wales schools project referred to by Mr Rich-Phillips.

The CHAIR — I can give you a copy of the document the committee has been provided with. You might like to have a quick flick through it.

Mr CLARK — The second bullet point on page 5 refers to a 4 per cent net present value benefit. I assume the wording intended to say 'over 30 years'. You may want to take it on notice, but I would be interested if you could tell the committee how that 4 per cent figure would have been arrived at. Also, in terms of the risks taken on by your consortium, it looks like it is a pretty comprehensive assumption of risk. Perhaps the best way of asking the question is, what risks would have remained with government under that deal, and therefore what premium is the government paying to have the remaining risks taken off its hands?

Mr OPPENHEIM — In relation to the 4 per cent and the way that is derived, I believe that is just quoting back what the New South Wales government stated in that it had a public sector comparator or a benchmark calculation that said, 'If we were to do it ourselves this is what it would cost', and then it has done a NPV of the deal it signed with our consortium and simply said, 'The deal we have signed is 4 per cent cheaper than if we had planned to do it ourselves'. Exactly how they constructed their benchmark I am not clear on. It is literally just quoting back.

Mr CLARK — On the second aspect about the risk assumption, are there any other major risks that remained with government under that deal?

Mr OPPENHEIM — In terms of the risks that were transferred, they were transferred very comprehensively. Obviously the main area that the state was very keen to ensure it retained control of, and therefore there are some risks that essentially run with that, was education itself — the delivery of education from the facility. While all risks associated with the facility are passed to the consortium — the design, construction, maintenance, the whole upkeep of those aspects — to the extent there is, for example, a change in education methodology and the way classrooms need to be configured, any sorts of changes that are driven by educational needs or driven by the education system, the risks of those remain with the state. Ultimately there is a recompense method for any sorts of changes that are driven out of education, or any risks or events that arise as a result of the way the state chooses to operate those facilities.

Mr CLARK — Would the state retain the same sort of flexibility on how maintenance over a 30-year period would be done compared with if it owned the buildings itself? Sometimes if you maintain or upgrade you can reconfigure to meet evolving needs — for example, wiring for IT et cetera. Did the state retain the same sort of flexibility under this project?

Mr OPPENHEIM — I believe it retained a degree of flexibility. But ultimately the way in which they are maintained is passed to the private sector, so there are a bunch of performance standards which must be met and there are obviously abatement provisions. The way in which those standards need to be met is largely to be determined by the private sector. The important thing was to not constrain the principal's use of the school. The principal had to remain in full control of the school and be able to use it so you could not use maintenance to say, 'No, you cannot have whatever it is you want to have', or, 'You cannot use it for weekend activities' and the like. There was an important constraint to ensure the principal was always the controller of the asset.

In relation to IT, I would have to check the absolute specifics of how that is dealt with. I do not think the state always has the flexibility to override, if you like, a process if that is outside what was originally intended, and a mechanism for costing that.

The CHAIR — Thank you, Mr Oppenheim, this has been most useful. The committee will provide you with a copy of the transcript for you to make any typographical changes you pick up.

Witness withdrew.

CORRECTED TRANSCRIPT

PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

Private Sector Investment in Public Infrastructure Subcommittee

Inquiry into private sector investment in public infrastructure

Melbourne – 27 January 2004

Members

Mr W. R. Baxter
Ms C. M. Campbell
Mr R. W. Clark
Mr L. A. Donnellan
Mr B. Forwood
Ms D. L. Green
Mr J. Merlino
Mr G. K. Rich-Phillips
Ms G. D. Romanes

Chair: Ms C. M. Campbell
Deputy Chair: Mr B. Forwood

Staff

Executive Officer: Ms M. Cornwell

Witness

Ms C. Hilder, Director of Government Affairs, Australian Council for Infrastructure Development.

Necessary corrections to be notified to
executive officer of committee

The CHAIR — I welcome Ms Cecilia Hilder to the public hearing on private sector investment in public infrastructure. All evidence taken by this subcommittee is taken under the provisions of the Parliamentary Committees Act and is protected from judicial review. However, any comments made outside the precincts of this hearing are not protected by parliamentary privilege. All evidence given today is recorded, and you will be provided with a proof version of the transcript shortly.

This is the subcommittee's final hearing, so it thought it would be really helpful to include any comments you would care to make in relation to the latest of the Victorian reports, being Peter Fitzgerald's *Report on the Review of Partnerships Victoria Provided Infrastructure*, and particularly on the capital asset pricing model. The subcommittee has a number of specific issues to raise with you.

Ms HILDER — I was asked today to speak about the Fitzgerald report. When I was putting my presentation together, the word that kept coming up in my head was 'perspective', because I think there have been so many aspects of the debate surrounding that draft report that have been really out of perspective. So I guess my comment tag was 'PPPs — perspective, perspective, perspective' in relation to the Fitzgerald report. I have distributed two brief pages that really outline what I want to say today. In addition to that there is a list of the member companies of the Australian Council for Infrastructure Development (AusCID).

The first area that I wanted to speak about in terms of the infrastructure in the privates sector in perspective in relation to the Fitzgerald report was that Peter Fitzgerald notes that the current infrastructure spend in Victoria in terms of private sector investment is between 7 per cent and 10 per cent. So for all the attention that is being paid at the moment we are talking about 7 per cent to 10 per cent of the state infrastructure spend. For that reason alone we would support Mr Fitzgerald's review of major projects, because there are around 90 per cent to 93 per cent of projects that are not necessarily receiving as much scrutiny.

We see the Fitzgerald draft report as a really important step in improving the scrutiny of the state infrastructure spend. I think he has done that in terms of calling for a broad review, or a broader review in a comprehensive way, so in that respect it is a really good step in the right direction. It is worth noting that in the United Kingdom the private sector infrastructure spend is around 10 per cent to 13.5 per cent.

The second point to make in that regard is that if the state's private sector infrastructure spend is between 7 per cent and 10 per cent, it is worth noting that Mr Fitzgerald found average weighted savings of around 9 per cent. So if we are saving around 9 per cent, then we would say that where appropriate there is scope to increase the use of the policy.

In terms of the discount rate debate in perspective, this is an area that I really do not want to go into too much detail about, simply because there are people far more qualified than I to go into the detail — and I am guessing the subcommittee has already spoken to a number of them. AusCID's position is that we really do not think a change is necessary at this point. It is worth noting that the government released extra guidance material in July last year and we would suggest that for that reason alone the current methodology has not perhaps been given a sufficient chance to be implemented and that a change is not warranted at this point.

A more important point in relation to that is that in many ways it is a second-order issue, to be frank. Deal flow — having sufficient deals going to market — is of greater importance in getting value for money for the state in terms of creating a competitive market; and bid costs, again in terms of creating a competitive market for the state and giving the state value for money. A greater focus and attention on deal flow and bid costs is really more important than the focus on the discount rate debate at this point.

Finally, I do not know that sufficient attention had been paid necessarily to the benefits that private sector investment has brought in Victoria, as shown in the Fitzgerald report. As I have said, there are average weighted savings of 9 per cent.

There are a few choice quotes, if you like, from the draft report that I have written down — for example, Fitzgerald states that the eight projects examined have the potential to demonstrate innovation, certainty of timing and cost, and the delivery of high-quality whole-of-life management of facilities. It is slightly jargonistic to some extent, but I think there are some really good points there that deserve to be picked up on. Again Mr Fitzgerald states in the report that it is clear from the project contractual arrangements to date — so these are deals that have been done — that there are credible promises of innovation, design, timeliness of delivery and certainty of price. I do not know that those comments have made it very far in some of the public debate.

In my concluding comments I refer to the need for streamlining of the bidding process. It is worth noting that Fitzgerald himself has said that it is recommended that the objective of streamlining the bidding and contractual processes should be one of continued priority to ensure bidders are encouraged to participate; you need a healthy market to get value for money. Again I have mentioned a steady flow of projects is required, and we would support the recommendation to publish 5 and 10-year pipelines of deals.

With regard to a couple of the other specific recommendations, we would support the recommendation for further developing capabilities across government. For a long time now AusCID has advocated improving government expertise in this area. Finally, we support cross-jurisdictional collaboration, but that is already happening as well.

The CHAIR — In regard to your second last point relating to further developing capabilities across government, do you have examples of where you believe that can be improved and where governments, either nationally or internationally, have models that we should follow or at least seriously consider?

Ms HILDER — To speak about Victoria first, I think there are certain departments and certain areas — I will not be specific because it varies — that have terrific expertise and where the level of infrastructure procurement knowledge is the best it has been perhaps in some areas. I do not know that that is the case across the whole of government. I think we need to ensure that knowledge is spread across government so the government has the confidence to do deals; and it also improves value for money if everybody is confident in what they are doing — I guess that is the way to put it.

In terms of expertise, I think some of the ways we are doing it here in Victoria are among the best, and I am referring in part to the courses at Melbourne University Private. But the UK government has set up Partnerships UK, which acts as a resource base, if you like — which I think the subcommittee visited.

The CHAIR — You said that in Victoria there are some departments and some areas of departments that are better than others. Have you been able to identify why it is, or what are the precursors to those kinds of results showing up to AusCID?

Ms HILDER — I think in some ways it is just by virtue of the fact that some departments have been at the front line of this.

The CHAIR — Experience?

Ms HILDER — I guess that is a better word. Thank you.

Mr CLARK — I refer to the second point in you opening remarks. What are AusCID's views about the current flow of projects in Victoria, and what effect is the current flow of projects in Victoria having on the ability and willingness of AusCID and its members to maintain a presence in Victoria and devote resources and facilities in keeping offices open in Victoria to bid for Victorian projects?

Ms HILDER — I think we really support the government's budget papers in the way that is in last year's budget papers it put forward a list of projects under possible consideration. We hope that will occur again this year. Some of the projects that were listed in budget paper 2, I think, have come to fruition as PPPs — specifically the showgrounds redevelopment and the Royal Women's Hospital. We would like to continue to see that happening, and it goes some way towards Fitzgerald's recommendation on a pipeline of deals. But we would like to see, where possible, greater certainty in that regard.

What is happening in Australia is that the market has become bigger, if you like, and what I mean by that is that the private sector has more choices perhaps than it did before; there is quite a pipeline of deals around the country. If you were to ask me specifically about Victoria, I think we are in need. The private sector does need greater certainty than it has at present as to the deals available. I think there may be some concern in terms of being able to plan resources. It is very important that companies are able to plan for the future and put their resources where they are needed.

The CHAIR — The showgrounds and Royal Women's Hospital projects were flagged, if I recall correctly, in the budget papers as possible private Partnerships Victoria projects. Do you have a comment on traditional procurements and flagging those in budget papers so that industry knows what is likely to be on the horizon?

Ms HILDER — I think that whether they are doing a traditional D and C or a PV project the more information that can be forthcoming from government about potential projects, the better. It enables companies to better plan their expertise, capital and resources; and also the state gets better value for money.

The CHAIR — And does it matter under which heading it comes from the AusCID's members' point of view?

Ms HILDER — The only reason that I hesitate is that it matters to some companies, depending on what they do. To some companies it matters more than others — that is the reason for my hesitation.

Mr DONNELLAN — The Deputy Prime Minister announced the federal government was going to be spending something like $2.4 billion over the next couple of years on roads. I note in his paper 'The future for Australian infrastructure', Dennis O'Neill referred to the importance of any strategy of linking rail and transport. Do you have any comments to make on that announcement, or have you not had a chance to look at in detail?

Ms HILDER — I have not looked at in fine detail in the web site. I certainly followed the announcement. I do not know if you have AusCID's media release on that.

Mr DONNELLAN — I have some concerns that there is actually no particular strategy to say what we are going to link in and how we are going to go about it; it is probably more smaller roads and things like that. Some of them are vital, but it appears there is not a strategy, which obviously Dennis O'Neill was asking for.

Ms HILDER — To answer your question specifically, the keynote in our media release was that we see that, if you like, as a good start in terms of the Auslink land transport plan. We see it as a positive, but it needs to be, if you like, a precursor to the money and the plan, the white paper that was promised in relation to the May budget.

So there was an announcement for $870 million worth of land, and you have now had $2.4 billion on roads and then we will get the white paper in May and additional funding for that. So we are very keen to see that that allocation of money is linked to that land transport strategy.

The CHAIR — Thank you.

Mr RICH-PHILLIPS — When you last appeared 18 months ago two issues that you raised in particular were the need for a whole-of-government approach and transaction costs, which is a recurring theme. Has the Australian Council for Infrastructure Development noticed any improvement in those two areas over the last 18 months since you first gave evidence before this inquiry? Is there a change in the way government in Victoria is operating with PPPs?

Ms HILDER — I think in terms of whole of government I can answer that by saying that we would like to see more projects, but I think if you look across the breadth of projects to be done and being done, they are quite cross-departmental, if you like. So in terms of the whole-of-government approach the projects now cover a number of areas, whether it be health, justice or traditional transport, but those kinds of areas. But I again go back to my comments earlier about needing to continue the expertise across government.

Mr RICH-PHILLIPS — Consistency of approach?

Ms HILDER — Yes, just in improving knowledge, if you like. In terms of transaction costs, I think this is in part a double-edged sword in the sense that while we can streamline processes to a point in looking at the academics of the process, it is only through experience and practice and doing deals that we can really get to improving the transactions costs as has proven to be the case in the United Kingdom. So frankly a large part of doing it is doing the deals.

Mr RICH-PHILLIPS — Does your organisation have any experience of state jurisdictions in Australia doing it better?

Ms HILDER — I can only point to pedantic specifics in a sense. The question is hard to answer in part because so much of the other states and the Northern Territory's policies were modelled on Victoria but anecdotally I am told that the Southbank TAFE expression of interest was a really good document. So I do not know that any one jurisdiction is doing it better or any one project is a stand out at the moment. It seems to me that there are little bits that you hear.

Mr RICH-PHILLIPS — On a project-by project basis there is no consistency?

Ms HILDER — We would really support what is proposed here with the Premier's announcement about a national PPP council, a cross-jurisdictional approach. To some extent pleasingly that is already happening but we would always like to see more of it. We are a large land mass with a relatively small population and the more knowledge we can exchange across the country, the better.

Ms ROMANES — In terms of the maturity of the market, what has been the effect of the takeover of a number of companies? What has that meant for the bidders available for PPP projects?

Ms HILDER — I think that is a really good question and again it gets back to ensuring that there are sufficient deals to go to market. I do not know that at this point it has had a terribly significant effect, but I think your question is a really good one in terms of the government needing to watch the market and the state of the market. We live in a global world and it is very easy for companies to do deals overseas. Increasingly we see some Australian companies doing infrastructure deals overseas.

Ms ROMANES — We need to attract them also within this market and we need to attract other companies from overseas.

Ms HILDER — We would always want to attract others. I think it is worth keeping in mind if you note from the list of members that we have that there are a lot of Australian companies but there are also a lot of companies based overseas. I think we already have a broad range of infrastructure investment and we need to encourage and nurture that market to ensure that we have the best of the best competing for the best projects to get the best value for money.

The CHAIR — You have made the point about nurturing the market. What is your organisation doing and what do you think the state government or other governments, be they state, territory or national, should do to nurture the market?

Ms HILDER — I do not know that government has the responsibility to nurture in the full sense of the word, but government needs to be in constant dialogue. It needs to be aware of what the private sectors needs are, if you like, just as the private sector needs to know what governments drivers are. Does that answer your question?

The CHAIR — Sort of.

Ms HILDER — It is about understanding each other and being in constant communication and working together, to use a phrase.

Mr BAXTER — Turning to my old friend the PSC and looking at your table here, and looking at the Echuca-Rochester waste water showing 28 per cent savings against the PSC — —

Mr FORWOOD — It is in your electorate, isn't it?

Mr BAXTER — Yes — that has got nothing to do with the question, Mr Forwood. The Wodonga waste water treatment plant is also in my electorate and again nothing to do with the question. The table shows a dash. Just to make sure that my understanding is correct, why are there no savings shown against Wodonga? Does it match the PSC? Was one not done?

Ms HILDER — All I have done with regards to that is do a table of Mr Fitzgerald's findings on each specific project. You have caught me out on the specifics with regard to Wodonga. I think the point about the County Court, for example, was that a large part of it was done prior to the Partnerships Victoria policy, so there was not a PSV, but I am not sure on the specifics of Docklands and Wodonga but I can check and take it on notice.

Mr BAXTER — It might apply in Wodonga, too, because it is up and running. It seems to me that they were two very similar projects and one would expect if the PSC has any use at all, it should show savings somewhat similar but perhaps the answer is that it was not done in Wodonga's case. I will have to look for another example to test my theory later on.

Ms GREEN — In terms of your response to Ms Romanes before, and it was one of the concerns that I had when we heard evidence overseas, noting that we are on 7 per cent to 10 per cent and the United Kingdom is on 10 per cent to 13.5 per cent, what really concerned me was that in some particular sectors in a whole lot of countries, and Europe in particular — and I will use water as an example — there is a large increase in market share and market power of a couple of players when you look at 30-year deal terms and in the French example it was 70 years. There are only a small percentage but if government vacates the field too much in terms of leaving this to the market, then we could really be leaving ourselves open in the long term.

Ms HILDER — I think that is an interesting question and the best way to answer it is that it is a really interesting point at the moment where there are an increasing number of companies and investment vehicles, and we read every day in certain newspapers about those wanting to invest in infrastructure. So in one way the market is getting broader and in another area of the market we see companies buying each other out. So I think we stand at a really interesting threshold point, if you like.

On some aspects it is getting broader and that is a positive to the point where some members of the private sector will now say that the competition is tough because there are so many players, whereas in other areas governments are starting to have concerns that the competitive tension is not there. So again I think we get back to streamlining the processes; we get back to making sure there are sufficient deals to go to market, and we get back to watching what the market is doing. I do not know that there is an easy answer to it. How do you stop companies buying each other out? I do not know that I have answered your question because I do not know that there is an easy answer to it.

Mr FORWOOD — I want to ask about the public sector comparator. Do you have a view about its usefulness?

Ms HILDER — I think it is useful in that it is terrific to see the analysis of looking at what a project may cost over its life. Sometimes I think we forget what a new development that is and how positive that can be from almost an academic or theoretical perspective.

To put it in the context of the Fitzgerald report, I do not know that the PSC should be the only criteria for deciding whether a project is suitable for private sector procurement. In a slightly related way there may be some areas where government does not have the intellectual property, for example, on certain projects. The one that comes to mind is the New South Wales government's PPP on waste with GOL technologies where the government does not have that intellectual property, and so doing a deal with the private sector is a way for the government to get that. You almost cannot have a PSC in that case.

Mr FORWOOD — They did not use a PSC?

Ms HILDER — I would have to take that on notice. I do not know but it is a case in point where — —

Mr FORWOOD — Did they go to tender on that project?

Ms HILDER — Again I will have to take that on notice. I will have to check the specifics.

Mr FORWOOD — It seems to me pointless to artificially create PSCs if the government has no capacity to build the project itself in the first place. You are better just to go to market if you want to do the project, and if you cannot afford it then do not do it. Why spend your time and energy on creating an artificial PSC?

Ms ROMANES — Is that an intellectual exercise that can help the public service work through — —

Mr FORWOOD — I think you can do the risk issues completely independently, of actually then using a discount rate and coming up with a dollar figure, which we know from the evidence we got overseas that people if they want to — and I will not use the word again — manipulate — and I did use it!

You do not get a concern from your members about going up against an artificial mechanism like the PSC?

Ms HILDER — At times there can be concerns about it. A number of members would support disclosure of the PSC.

Mr FORWOOD — When?

Ms HILDER — Specifically I am not sure but there is increasing desire to see the specifics, but again it varies across the membership; some do, some do not.

Mr FORWOOD — That would be absolutely right with your membership.

Mr MERLINO — This is a question about transparency, Is there a common view across your membership in terms of greater transparency, for example, disclosing contract details on the Internet post finalisation of the contract?

Ms HILDER — I think it is a point sometimes forgotten. I actually think we stand at a point where in some ways we have never had more disclosure through the Internet and so forth. I understand all deals over $10 million are on the web, and there are some specifics — —

Mr FORWOOD — Bits of them are.

The CHAIR — Over to you, Ms Hilder!

Ms HILDER — So it is always worth remembering that we stand at a point in time of great disclosure. The other thing is that in some ways there is disclosure almost because government now publicly works with the private sector, so there is also a degree of media scrutiny on some of these projects we have not always had in the past and perhaps we can see that as a positive. To be frank, investors love certainty and transparency. In many ways the more certainty there is, the happier they are, so we would support calls for greater transparency.

The CHAIR — By way of conclusion, Mr Forwood and Mr Baxter mentioned the public sector comparator and making it public. If it were made public, how much extra do you think the private sector would be prepared to put out there in the public arena? What is running through my mind at this point is that I imagine that if the public sector comparator were put out in the public arena, that there would be a call for greater transparency in terms of that sector's costs and calculations.

Ms HILDER — I cannot answer your question, Christine, largely because I think I would get different answers from different members. I hope I am not avoiding your question, but you would have to ask individual companies, and I would suggest that they would all have different views.

The CHAIR — Thank you very much. We appreciate the fact that you have given evidence to this committee twice. I hope it has been a worthwhile experience from the perspective of your organisation as well as from your own perspective. Thank you very much. We will be following up with copies of the Hansard transcript. If there are any questions that you have taken on notice, they will be circulated to you by correspondence. Thank you very much.

Committee adjourned.