march 09

trp
09-1

New South Wales
TREASURY

NSW public private partnerships policy – an evolution

Office of Financial Management

Research & Information

Preface

Public Private Partnerships (PPPs) are increasingly being used to procure public infrastructure world wide. New South Wales (NSW) has been using the PPP model as a form of procurement for over two decades. Since the inception of PPPs in the mid 1980s, there has been significant policy development to assist PPP procurement.

In 2008 the Australian Government announced a new, national approach to planning, funding and implementing the nation's future infrastructure needs. In April 2008, the *Infrastructure Australia Act 2008* came into effect paving the way to establish Infrastructure Australia (IA).

A strategic blueprint for our nation's future infrastructure needs will be developed by IA, in partnership with the states, territories, local government and the private sector. IA will provide advice to Australian Governments about infrastructure gaps and bottlenecks that hinder economic growth and prosperity. IA will also identify investment priorities, policy and regulatory reforms, which will be necessary to enable timely and coordinated delivery of national infrastructure investment.

On 29 November 2008, the Council of Australia Governments endorsed the National Public Private Partnership Policy and Guidelines. All Australian State and Territory Government agencies will now apply the National Policy and Guidelines. The National Policy and Guidelines effectively replace previously existing policy and guidelines in those jurisdictions.

The development of the National Policy Framework involved a cooperative effort by all Australian jurisdictions. As part of this process, NSW Treasury prepared this information paper to facilitate the harmonisation process, by documenting the evolution of PPP policy in NSW.

Michael Schur
Secretary
NSW Treasury
March 2009

Treasury Ref: **TRP09-1**
ISBN: **978-0-7313-3409-4 [print]**
978-0-7313-3410-0 [electronic]

Note
General inquiries concerning this document should be initially directed to:
Danny Graham, on tel: 9228 3213, or e-mail: danny.graham@treasury.nsw.gov.au

This publication can be accessed from the Treasury's Office of Financial Management Internet site [http://www.treasury.nsw.gov.au/].
For printed copies contact the Publications Officer on Tel: 9228 4426.

Contents:

Executive Summary

The modern Public Private Partnership (PPP) model of privately financing public infrastructure had its genesis in the Sydney Harbour Tunnel (SHT) project in the mid 1980s[1]. While initially focusing on economic infrastructure, PPPs have been used over the last decade to procure social infrastructure assets and associated non-core services.

Considering NSW and Victoria have now been using the PPP model of procurement for more than 20 years, a clear evolution of policy and practise can be traced. The public sector has developed the necessary skill base to procure infrastructure by way of PPP, with the private sector becoming increasingly innovative and adding significant value to public procurement. This has seen dynamic changes to the way Industry and Government interact.

In NSW the introduction of the UK PFI social infrastructure policy was adopted through a Green Paper in 2000, which led to NSW Treasury publishing the first *Working with Government: Guidelines for Privately Financed Projects* (WWG) in November 2001.

NSW has procured schools, hospitals, prisons and social housing in a short period of time since the release of the first WWG in 2001. The NSW Schools I & II projects are viewed by many in Industry and Government, as being an example of social infrastructure PPP best practice.

Social infrastructure PPPs have unique budget and accounting implications. NSW Treasury adopts a budget rule, a framework which is also adopted in Victoria. The budget rule separates the investment and financing decisions. By adhering to the budget rule, the Government dispels the common misconception that PPPs are an alternative to Government borrowing. That is, PPPs are not used as a means of extending the State's budget constraint. While private finance may be used to initially construct the infrastructure, it will ultimately be funded by Government through ongoing payments over the life of the contract.

The Government has learnt to deal with risk allocation flexibly, as it is an extremely complex issue for social infrastructure PPPs, and a driver of value for money. Risk allocation requires the need for a well thought out engagement strategy, particularly at the Request for Detailed Proposal stage. NSW and Victoria have learnt that a good engagement process aids in aligning the public and private sectors understanding in optimising outcomes, resulting in an efficient allocation of risk.

In recent years, the financing of PPP projects has become complex. This can be partly explained by the skills a consortium acquires with the Australian investment bank driven model, and also reflects the development of new financial instruments in the market. The Global Financial Crisis is impacting on the financing of PPPs, which will likely see the PPP model adapt to the changed financial market circumstances.

Since the SHT, PPPs have been able to evolve to changing influences. Although PPPs have received a great deal of scrutiny in recent years, they have been able to adapt to the requirements of users and tax payers. Government has introduced a number of safeguards to reassure the public that PPPs will only be entered into when they are in the public interest, and provide the people of NSW with value for money.

[1] Working with Government: Guidelines for Privately Financed Projects gives a discussion of the difference between a pure PPP style project and a PPP that involves private financing, called Privately Financed Projects in NSW.

1. Introduction

Private sector involvement in the delivery of public infrastructure is not a new concept. The United Kingdom was the modern instigator of the new wave of private sector involvement, through the development of the Private Finance Initiative (PFI) in the 1990s. In New South Wales (NSW), Public Private Partnerships (PPPs) have been used for over two decades.

The current PPP model of privately financing public infrastructure had its genesis in the Sydney Harbour Tunnel (SHT) project in the mid 1980s[2]. While initially focusing on economic infrastructure, PPPs have been used over the last decade to procure social infrastructure assets and associated non-core services.

Since the opening of the SHT, there have been a number of economic and social infrastructure projects procured in Australia, primarily in NSW and Victoria. Both States' PPP experience covers a diverse array of sectors, with NSW now having procured infrastructure by way of PPP in the following sectors:

- motorways
- heavy and light rail
- housing
- health
- correctives
- energy
- Olympic infrastructure
- diversion of waste from landfill
- household water treatment
- waste water recycling.

Considering NSW and Victoria have now been using the PPP model of procurement for more than 20 years, a clear evolution of policy and practise can be traced. The public sector has developed the necessary skill base to procure infrastructure by way of PPP, with the private sector becoming increasingly innovative and adding significant value to public procurement. This has seen dynamic changes to the way Industry and Government interact.

A brief discussion on the evolution of PPP policy in NSW follows. First the development of the toll road economic infrastructure PPP model will be discussed, followed by the more recent development of social infrastructure PPPs, taking into account policy development and reviews that have taken place over time. A discussion outlining the evolution of private sector financing of projects will follow. Finally, the paper will discuss a number of policy issues incorporating tax implications, the management of public interests, and stakeholder management - using the development of Labour Service Agreements as an example.

---

[2] Working with Government: Guidelines for Privately Financed Projects gives a discussion of the difference between a pure PPP style project and a PPP that involves private financing, called Privately Financed Projects in NSW.

2. Economic Infrastructure

The WWG defines economic infrastructure as:[3]

> Fixed assets that support economic activity and development in a fundamental way. Typical examples of economic infrastructure are networks of roads, telecommunication facilities, airports, ports, water storage distribution and sewerage, railways, electric power generation and distribution facilities.

Typical characteristics of economic infrastructure are:

- private revenues are derived from third party users
- the private provider faces market / demand risk
- traditionally delivered through a Government Business Enterprise (including a state-owned corporation)
- revenue risks are a key driver of financial outcomes.[4]

The SHT is an interesting project for a number of reasons. The project was an unsolicited proposal from Transfield/Kumagai, received by the Department of Main Roads in 1985. Being the first unsolicited proposal, the project was not market tested or put out to competitive tender, processes now required under modern policy. The lack of competitive tension surrounding the project concerned many, including the Auditor-General.

The SHT is unique in that the project was governed by its own legislation – the *Sydney Harbour Tunnel (Private Joint Venture) Act 1987* (the Act). The Act was necessary due to Government not having a policy apparatus in place to deal with PPP procurement in the 1980s. The Act also set out the Government's responsibilities and streamlined planning approvals.

The need for the SHT's own legislation also reflected the fact that NSW did not have an appropriate legislative regime in place to regulate PPP transactions. Furthermore, NSW did not have a central agency designated as the first point of contact for the private sector.

The SHT also raised a number of tax issues which had not been previously encountered. The Australian Tax Office was concerned that the private sector was going to become eligible for capital allowance deductions that did not exist before the advent of large infrastructure sales, and later PPPs. The Federal Government introduced section 51AD of the *Income Tax Assessment Act 1936* – prohibiting capital allowances deductions in respect of property used in certain leveraged arrangements i.e. the SHT.

---

[3] NSW Treasury, 2006. Working with Government: Guidelines for Privately Financed Projects page 83. http://www.treasury.nsw.gov.au/wwg

[4] NSW Treasury, 2006. Working with Government: Guidelines for Privately Financed Projects page 54. http://www.treasury.nsw.gov.au/wwg

Following the opening of the SHT, the NSW Government released *Guidelines for Private Sector Involvement in Infrastructure Provision*, which clarified the management of unsolicited proposals and how they should be processed, including intellectual property rights associated with proposals.[5] These Guidelines have evolved over time and now take the form of the WWG.[6]

A number of toll roads in NSW have been procured since the SHT, implementing valuable lessons learnt. Sections of the M4 and M5 motorways that were procured through PPPs saw the introduction of a competitive tender process.

Positive attributes coming out of the M4 and M5 were that the operators accepted all patronage and cost escalation risk without recourse to Government, while the RTA retained the risk of property acquisition and took interest rate risk up until financial close.

The M2 Motorway in Sydney is recognised as a groundbreaking project due to the broad inclusion of lessons learnt from past projects. A defining characteristic of the M2 was the fact the project had to deal with adverse economic conditions during procurement in the early 1990s. Other defining features included:[7]

- rising interest rates during the assessment and negotiation period of the detailed proposals, resulting in an increase in the Government contribution from zero to $59m
- the inclusion of a Material Adverse Effects clause in the Project Deed which became a model for later projects.

In light of the Auditor-General’s negative opinion of the SHT procurement process, the Auditor-General concluded that the M2 contractual arrangements had soundly transferred and valued the project’s risk. The M2 contract and financial structure was used as a model for the CityLink project in Melbourne, Australia’s first fully electronic toll road.

More recently the Cross City Tunnel, Westlink M7, and Lane Cove Tunnel projects have been procured by way of PPP. The experiences associated with these projects further refined PPP procurement of economic infrastructure.

The Cross City Tunnel consortium originally offered to pay the NSW Government for the concession as part of their bid. While there has been a change in ownership of the Cross City Tunnel following the financial difficulties experienced by the initial owners, the project was delivered to the public at zero cost to Government. The contractual arrangements and the project’s risk allocation shielded Government from patronage and associated ramp-up risks.

---

[5] Current NSW Treasury guidance regarding intellectual property can be found at: http://www.treasury.nsw.gov.au/wwg/intellectual_property_guideline_for_unsolicited_private_sector_proposals_submitted_under_working_with_government

[6] Working with Government: Guidelines for privately Financed projects can be found at http://www.treasury.nsw.gov.au/wwg

[7] Humphrey, Garry. 2008, Toll Road Procurement in NSW, presentation to the National Electronic Tolling Committee Industry Forum in Melbourne, April 2008.

The North-South Bypass Tunnel in Brisbane highlighted the evolution and growing consistency in economic infrastructure PPP contracts, using its predecessors as the initial pro forma. ConnectEast in Melbourne also added to the development of optimal contract and risk allocation practises for economic infrastructure PPPs, with a legacy of the Westlink M7 being the first distance based fully electronic toll road in Australia.

The RTA considers the lessons learnt through previous projects has lead to changes to their PPP procurement practices, which include:[8]

- conforming proposals based on the RTA's concept design were invited with opportunity to submit optional variants
- registrations of interest were invited instead of preliminary proposals, as the RTA was specific in detailing its concept design, ultimately being less costly to the private sector
- financial parameters, e.g. toll charges, toll indexation regimes, and terms for conforming proposals were defined
- the scope of works and technical criteria were enhanced over previous projects, to ensure that the Government's project requirements were met through private sector delivery
- the confidentiality and probity of the RTA's assessment process were improved
- the proposals were exhaustively reviewed by RTA and its technical, financial and legal advisors to ensure that proposals were acceptable to Government, future users and the community
- a comparative value assessment was undertaken against a 'public sector comparator' – a hypothetical, risk-adjusted estimate of the net present cost of delivering the project through traditional procurement
- competition was maintained throughout the tender phases
- the Minister for Planning's approval of the project was obtained prior to the submission of detailed proposals.

The greatest benefit that has evolved over time is the fact that the private sector has become aware of, and accustomed to, State Governments' preferred risk allocation in economic infrastructure PPPs.

[8] Humphrey, Garry, 2008. Toll Road Procurement in NSW, presentation to the National Electronic Tolling Committee Industry Forum in Melbourne, April 2008

3. Social Infrastructure

The WWG defines social infrastructure as:[9]

> Although loosely used, this term generally refers to items of physical infrastructure that aid the provision of social, rather than economic or industrial, services. Hospitals, schools, police stations, day care centres and prisons are examples of social infrastructure.

For social infrastructure PPPs, the assets created and associated services provided are usually paid for by Government from consolidated revenues in the form of monthly service payments (MSPs). Private providers are typically not exposed to market risk, with the MSPs being tied to a "payment mechanism" – an incentivised performance based payment regime that is structured around key performance indicators (KPIs). If the private provider fails to meet identified KPIs, their MSP will be abated accordingly. Cost and performance risks are a key driver of financial outcomes in social infrastructure PPPs.[10]

Social infrastructure projects were delivered in NSW and Victoria following the growing use of PFI in the United Kingdom. There has been a large amount of knowledge sharing between representatives of HM Treasury, NSW Treasury and Partnerships Victoria. In NSW, the introduction of the UK PFI social infrastructure policy was adopted through a Green Paper in 2000, which led to NSW Treasury publishing the first WWG in November 2001.

The WWG were updated in 2006, taking into account past lessons learnt and a number of the key recommendations from PPP inquiries. In May 2007, after industry consultation and feedback, NSW Treasury published *Risk Allocation and Commercial Principles,* a policy document which is primarily targeted towards the procurement of social infrastructure projects.

NSW has procured schools, hospitals, prisons and social housing in a short period of time since the release of the first WWG in 2001.The NSW Schools I & II projects are viewed by many in Industry and Government as being an example of social infrastructure PPP best practice.

The schools were built in high population growth areas on greenfield sites. The savings to the public were in excess of 20 per cent, with the Auditor-General's Performance Audit reporting that teaching staff were extremely happy with the arrangement, being able to focus on core activities rather than maintenance. Overall, the Auditor-General favourably viewed the PPP.[11]

In social infrastructure projects, it is up to the private sector to compete against a current Government service and also rival bids - creating two separate competitions. For example, a number of services were removed from the final Orange Hospital PPP following a value for money assessment, after the successful consortium stated that they could not match the public sectors efficiencies in some areas.

---

[9] NSW Treasury, 2006. Working with Government: Guidelines for Privately Financed Projects page 85. http://www.treasury.nsw.gov.au/wwg

[10] NSW Treasury, 2006. Working with Government: Guidelines for Privately Financed Projects, page 54. http://www.treasury.nsw.gov.au/wwg

[11] An overview of the report can be found at: http://www.audit.nsw.gov.au/publications/reports/performance/2006/schools_ppp/inbrief-schools.pdf

In October 2008, NSW showed that even in the most adverse economic conditions, a social PPP project can be delivered if its fundamentals are sound, reaching financial close on the Royal North Shore Hospital in Sydney. Contract negotiations and financial close were conducted during a time when project financing was extremely difficult.

Social infrastructure PPPs have unique budget and accounting implications. The NSW Treasury adopts a *budget rule*, a framework which is also adopted in Victoria. The budget rule separates the investment and procurement decisions, in accordance with the following:

1. Decision to ***invest*** (is the project worth pursuing?)
   - Cost Benefit Analysis / Business Case
   - Prioritisation.
2. Method of ***procurement*** (PPP?)
   - Value for Money
   - Public Interest.

By adhering to the above, the Government dispels the common misconception that PPPs are an alternative to Government borrowing. That is, PPPs are not used as a means of extending the State's budget constraint. While private finance may be used to initially construct the infrastructure, it will ultimately be funded by Government through ongoing payments over the life of the contract.

The Government strictly adheres to its budgeting policy and will only consider using a PPP for social infrastructure where projects:

- are part of an agency's capital expenditure priorities for service delivery
- are budgeted for by way of capital expenditure in an agency's forward capital budget (assuming traditional procurement)
- offer value for money compared with Government's traditional procurement methods.

For a social infrastructure project, an agency must have the budget to cover the service payments over the period of the arrangement. In proceeding with PPP procurement, an agency's original forward capital budget for the project, which assumes traditional procurement, is converted into PPP capital payments. Implicit in the MSP which the Government agency is required to pay to the private provider, is the recoupment of the providers capital cost associated with creating the asset.

The process of converting traditional capital funding into PPP funding requires a capital amortisation profile to be sculpted, with PPP capital being "dip fed" to the agency over the life of project to cover the capital component of the MSP. Service related components of the MSP are budgeted for as recurrent funding.

From an accounting perspective, social infrastructure projects are considerably different to economic infrastructure projects, resulting in different balance sheet impacts. Currently, there is no accounting standard for PPPs in Australia. The Australian Heads of Treasury, however, endorsed the UK FRS 5 as an accounting model. In applying this model, the majority of NSW social PPPs to date behave akin to a finance lease, with *AASB 117 – Leases* providing guidance on the accounting implications. Accordingly, the majority of social infrastructure PPPs are classified as on balance sheet transactions for Government.

It is through optimal risk allocation that PPPs ultimately provide value for money to Government. Further, PPPs provide potential for capturing efficiency savings, and lead to more stable and predictable expenditure and service levels. Social infrastructure PPPs allow agencies to focus on their core objectives – managing and delivering core services to the community – rather than micro-managing the supporting infrastructure.

4. Inquiries into Public Private Partnerships

There have been a number of inquiries into PPP projects in NSW. A possible reason for this was given by the Chair of the *Public Accounts Committee Inquiry into Public Private Partnerships* held in 2006:

> We note that less than ten per cent of assets are provided through these arrangements. However, because they tend to be large, complex projects that can affect people's lives for a very long time, PPPs arouse a great deal of interest and passion. [12]

This is possibly the reason why between 1992 and 2002, Public Accounts Committees have published 13 reports and discussion papers on PPPs, primarily focusing on accountability, governance and the financing of projects.[13]

The June 2006 *Public Accounts Committee Inquiry into Public Private Partnership* (the Inquiry) drew heavily on two other pieces of work, being the Infrastructure Implementation Group's *Review of Future Provision of Motorways in NSW* December 2005, and the reports of the Joint Select Committee on the Cross City Tunnel, tabled in February and May 2006.

The recommendations from the Inquiry were wide ranging, however stressed that public trust in PPPs would be improved markedly if disclosure of project particulars, notably the entire contract, were disclosed as per recommendation 13.[14] Another theme that ran throughout the Inquiry's findings was the need for a public interest test, while recommendation 20 suggested that there was a need for a standard contract. [15]

[12] Public Accounts Committee Inquiry into Public Private Partnerships: Report No. 16/53 (159) – June 2006. Page. vii. http://www.parliament.nsw.gov.au/prod/PARLMENT/Committee.nsf/0/6FB3D448CE8BF349CA2570700015952F

[13] ibid., page. vii.

[14] ibid., page. x.

[15] ibid.,. page. x.

NSW Treasury is the central agency responsible for the WWG and updated the *Guidelines* in late 2006 to:

- reflect changes in Government structure since the publication of the original WWG in 2001
- include a public interest evaluation, taking into account the perspectives of users and taxpayers
- require that at certain points throughout the tender process, updated public interest evaluations are to be completed, with significant variations submitted to the BCC, and requiring summaries of the evaluations to be publicly disclosed
- include updated sections discussing the environmental approval process to reflect the introduction of Part 3A of the *Environmental Planning and Assessment Act 1979*
- provide guidance on how agencies may use bidder engagement strategies, Best and Final Offers and pre-selection negotiations, and guidance on the evaluation of non-conforming proposals
- provide clarity on the role of the board of State Owned Corporations in the approval process for PPPs
- provide clearer Government approval processes, including requirements to seek further BCC approvals / advice if significant project factors change, or if an agency wishes to renegotiate a PPP contract
- provide consistency with the new FOI legislation on contract disclosure, including disclosure of the full contract and any amending deeds, excluding confidential material
- include a standard format for the preparation of contract summaries, as agreed between NSW Treasury and the Auditor-General
- provide for the continuation of the Steering Committee (or its equivalent), allowing the Committee to oversee the initial delivery phase of the project
- provide consistency with the Government's Procurement Policy Guidelines.

Following consultation with Victorian Treasury and Industry, NSW Treasury published the *Working with Government: Risk Allocation and Commercial Principles* in May 2007, responding to the Inquiry's recommendation for a standard contract[16]. Although not a standard contract *per se*, the guidance sets out the way Government prefers to manage risk and conduct PPPs within a legal framework.

In developing the commercial principles, NSW attempted to address the contentious issues surrounding service specification, site risk, performance bonding, liquidated damages, indemnities, and default and termination procedures. NSW has gone to great lengths to ensure that the commercial principles are broadly consistent with the Victorian position.

The Newcastle Mater and Long Bay Hospital Prison and Forensic PPPs, allowed NSW to develop a common set of commercial principles and risk allocations, which now apply consistently across projects. These projects also assisted in the development of:

- the use of a standard project deed that embodies a consistent set of underlying commercial principles and risk allocation
- consistent engagement strategies with the private sector
- a common set of assumptions for purposes of pricing a private sector bid.

[16] The document can be found at http://www.treasury.nsw.gov.au/wwg

Having key parameters known and understood by both public and private parties upfront, has enabled parties to address difficulties in the pricing of risks, as well as simplifying and shortening the procurement timeline. These developments have aided in the reduction of bid costs and reduced the time required for negotiations.

The Government has learnt to deal with risk allocation flexibly, as it is an extremely complex issue for social infrastructure PPPs, and a driver of value for money. Risk allocation requires the need for a well thought out engagement strategy, particularly at the Request for Detailed Proposal stage. NSW and Victoria have learnt that a good engagement process aids in aligning the public and private sectors understanding in optimising outcomes, resulting in an efficient allocation of risk. For example:

- based on consultation with the private sector, Government is now willing to share some of the interest rate risk for social infrastructure PPPs
- ensuring open communication channels between Government and the private sector during the design stage, helps draw a common consensus on service specifications, performance measures, payment mechanisms and other features of the contractual arrangement.

5. Change in financing structures

The nature of financing PPPs in NSW has changed dramatically since the construction of the SHT. Early economic infrastructure PPPs were primarily driven by contractors and tended to lack the type of consortium structures seen today – that is, there was not necessarily an investment bank directly involved, or other third parties contributing equity.

Due to contractors having limited balance sheet capacity, equity did not feature prominently in a project's capital structure,[17] with initial projects being mostly financed with bank debt.[18] This situation has changed remarkably over the last decade, with PPP financing structures potentially evolving further as a result of the Global Financial Crisis.

While the SHT was totally debt funded, the financiers, being risk adverse, were not willing to take patronage risk, which ultimately had to be underwritten by Government. The development of the toll road model has seen financiers willing to take patronage risk, as illustrated by the Cross City Tunnel project.

In recent years, the financing of PPP projects has become complex. This can be partly explained by the skills a consortium acquires with the Australian investment bank driven model, and also reflects the development of new financial instruments in the market.

An example includes the move away from traditional bank debt, to raising finance in debt capital markets. Financing packages have incorporated credit wrapped CPI indexed annuity bonds, providing an extremely competitive cost of funds. The ability of the private consortium to hedge out its interest rate exposure through an appropriate swap derivative, gives the Government MSP certainty. This type of debt has been used in projects such as the Rail Rollingstock, Orange Hospital and Lane Cove Tunnel projects.

---

[17] Graham, D. 1997, Transport Infrastructure – public or private? Transport Engineering Australia, vol. 3 no.1. page 11.

[18] ibid.,page 11.

Credit wrapping bonds, through a monoline insurer, has enabled BBB projects to issue AAA bonds in the capital market, allowing long term finance to be raised at a lower cost than would be available from other sources. The onset of the Global Financial Crisis and the demise of the monoline insurers, means that credit wrapped capital market bond issues are no longer a source of PPP debt finance.

The downgrading of the monoline insurers has had no effect on existing NSW PPP projects, as the insurance contract is between the monoline insurer, the project company (issuing entity) and the bond investors. The insurance policy will only be called if the project company defaults on its interest payments to bond investors. The downgrade of the monoline insurers, however, has impacted on the credit rating of the underling bonds that have been issued off the back of recent PPPs. For example, Rail Rollingstock bonds have been re-rated by Standard & Poor's to BBB+.

Since the onset of the Global Financial Crisis, there has been:

- illiquid bond markets
- no securitisation
- unprecedented increases in credit margins
- a thin domestic banking market as a result of foreign capital flight
- the need for the domestic banking market to fill the "debt gap"
- banks now taking a more risk adverse approach to funding – seeking to limit their exposure to individual projects
- combining to make it increasingly difficult to obtain debt finance for PPPs in the current market.

Current market conditions may yield further innovation in PPP financing structures, which may incorporate various forms of Government support and a move back to bank debt. In developing alternative financing models, the NSW Government will be cognisant of the following:

- the primary consideration is that any future asset acquisition and financing arrangements are to be managed in terms of efficient service delivery, rather than to generate rates of return for private sector investors
- the challenge is to design mechanisms to encourage long term investment in public assets that can provide the required services that are value for money.

6. The tax environment for PPPs

After a decade of inter-jurisdictional consultation, Division 250 of the *Income Tax Assessment Act 1997* was enacted to replace the draconian application of section 51AD and Division 16D of the *Income Tax Assessment Act 1936.*

Section 51AD was introduced in the early 1980s to combat an anticipated decrease in Commonwealth tax revenue, due to public infrastructure assets being sold to, and then leased backed from, the private sector. These transactions saw the private sector becoming eligible for capital deductions, which did not exist under State ownership. Section 51AD had the effect of denying these capital allowances when the end user of the asset was a *tax preferred* entity, whilst all revenues were assessable income in the hands of the taxpayer.

The NSW submission to the 1999 Ralph Review of Business Taxation called for an amendment to remove disincentives for private ownership of public infrastructure. The submission noted that section 51AD, and Division 16D - a similar regime for non-leveraged leases - were framed before PPPs became a major initiative, with their application now impeding private sector participation in public infrastructure.

Division 250 removes the threat of section 51AD applying. The Division applies an array of tests to determine the party which “effectively controls”, and therefore has the “predominant economic interest” in, the asset. Division 250 is summarised in the Act as follows:

> This Division denies or reduces certain capital allowance deductions that would otherwise be available to you (“*the taxpayer*”) in relation to an asset if the asset is put to a *tax preferred* use in certain circumstances.

Division 250 will apply where Government “effectively controls” the use of an asset that is leased, with the asset producing goods, services or facilities that are paid for by Government. If deductions are denied, the operative provisions re-characterise the arrangement as a sale and associated loan.

The development of Division 250 is a further area of policy that has changed recently to accommodate the existence of PPPs.

7. The management of public interests

One area that Governments have had to address is the lack of community trust in PPPs. This finding was alluded to in NSW PPP inquiries, with the NSW *Public Accounts Committee Inquiry into Public Private Partnerships 2006*, concluding there is ample evidence of widespread public scepticism of PPPs.
A lack of community trust has also been found in the UK.

Appearing before the Committee, an executive from Partnerships UK stated that "public scepticism about Privately Financed Initiatives is almost insoluble".[19] Accordingly, building public trust and engaging stakeholders in policy development is the foundation of good policy, and an area that the NSW Government has taken seriously.

A main public concern is the lack of transparency surrounding PPPs. In NSW, this has been address through the mandatory requirement of disclosing a contract summary, which has been certified as a fair representation by the Auditor-General. Contract summaries aim to provide a general overview of the entire contract. Project contractual documents are now also released to the public usually on the website of the procuring agency.

An agency must ensure that a contract summary is made available to the Auditor-General for audit within 30 days of the contract becoming effective. Within 90 days of receipt by the Auditor-General, the audited contract summary must be tabled in Parliament by the responsible Minister. After the summary has been tabled, the agency must advertise the availability of the contract summary in the Public Notices, with contract summaries also being placed on the Working With Government website at www.treasury.nsw.gov.au/wwg.

In NSW, a public interest test (PIT) is issued with expressions of interest for a project. The areas that must be addressed in the PIT are outlined in the WWG [20] and are required to be updated and submitted to Cabinet throughout the tender process. In addition, the RTA is proposing to develop a toll road specific public interest evaluation framework.

PITs also strengthen the value for money test, by addressing value from the perspective of the user and taxpayer. Therefore, Government and procuring agencies are working hard to make sure that PPPs are aligned with the interests of users and tax payers.

[19] Hay, N., Buchbach, V & Ohlin, J. 2006, Improving Public Private Partnerships in NSW, UNSW Law Journal, vol 29. no. 3. page 329.

[20] Working With Government: Guidelines for Privately Financed Projects, December 2006. NSW Treasury, pages 60-62. The document can be found at http//:www.treasury.nsw.gov.au/wwg

8. Engaging stakeholders: Labour Service Agreements

The inclusion of non-core services in social infrastructure PPPs may impact on an agency's existing workforce, where the non-core services are proposed to be provided by the private sector. The NSW Government has used Labour Service Agreements (LSA) to facilitate the change to a PPP model, in order to minimise the impact on existing staff.

When a PPP company takes over a function that was formally the responsibility of Government, it is of upmost importance to ensure a smooth transition for the existing workforce, taking into account the rights of current staff, while at the same time aiming to increase productivity. In attempting to reach the right balance, the Mater Hospital PPP formulated an LSA that had the following principles:

- the provision of non-core support services, as set out in the contract, is to be carried out by Government Health employees
- the PPP company manages the Government Health employees
- Health employees remain public sector employees with continuity of all entitlements.

The right to manage the Health employees covers:

- the day to day management, discipline and performance
- the Area Health Service (AHS) can step-in if they become aware of circumstances endangering any employee.

A PPP company has the right to terminate employees, however, this must be in consultation with the AHS such that:

- an AHS can accept or reject a termination recommendation; and
- if a termination recommendation is not accepted by the AHS, the Health employee can be redeployed elsewhere.

It is believed that LSAs strike a balance between increasing productivity and addressing the legitimate concerns of existing employees, by directly and openly engaging with employees and their representatives.

9. Conclusion

Since the SHT, PPPs have been able to evolve to changing influences. Given the Global Financial Crisis, it appears PPPs will have to adapt to a changing financial landscape. Although PPPs have received a great deal of scrutiny in recent years, they have been able to adapt to the requirements of users and tax payers. Government has introduced a number of safeguards to reassure the public that PPPs will only be entered into when they are in the public interest, and provide the people of NSW with value for money.

10. Further information

Contact Officer:
Danny Graham
Director, Private Projects Branch
P: (02) 9228 3213
F: (02) 9228 5748
E: danny.graham@treasury.nsw.gov.au