

Department of **Treasury & Finance**

# VALUE FOR MONEY IN A CHANGING WORLD ECONOMY

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# What is happening...

## For Government

- + Uncertainty surrounding project costs, timeframes and risks complicate project investment decision making
- + Concern with poor public perception of project delivery performance
- + Current practice doesn't achieve the best investment decisions

## For the Public

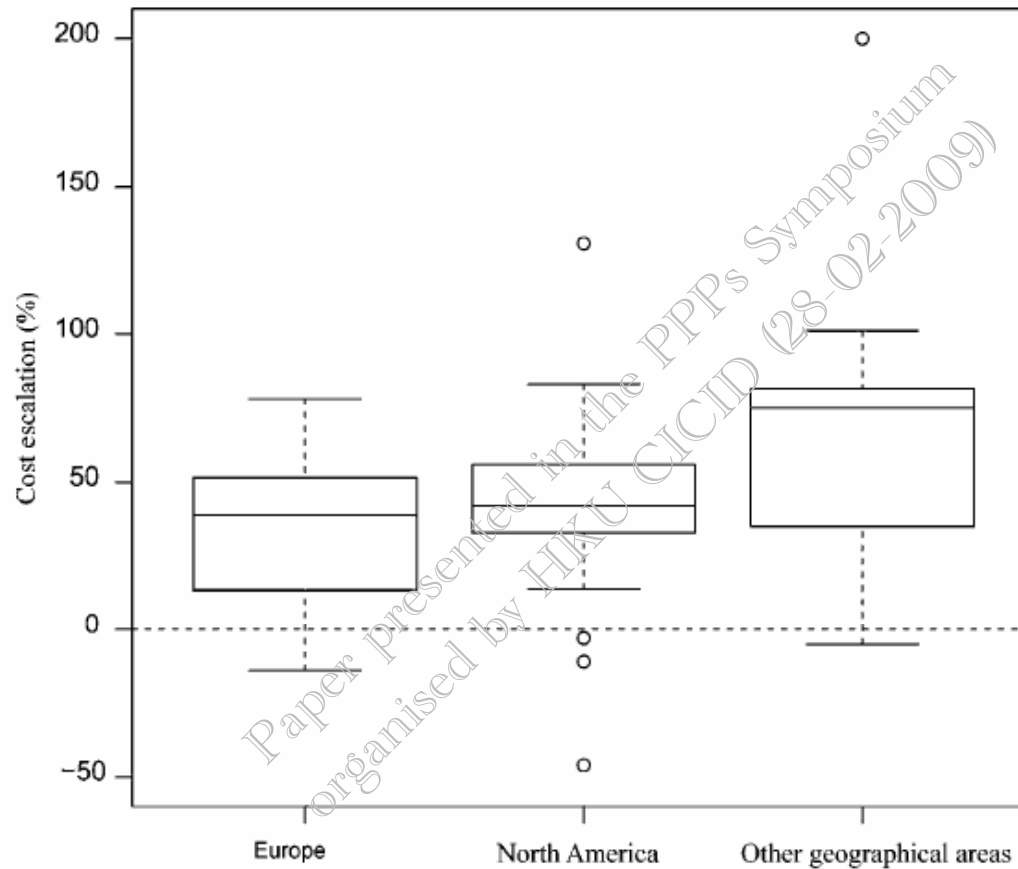
- + Perception of poor project delivery performance is reinforced by the media
- + Is National productivity and value for money being achieved?

## Cost overruns over time

+ Year	Project	Cost overrun
+ 1869	Suez Canal	1900%
+ 1883	Brooklyn Bridge	100%
+ 1914	Panama Canal	200%
+ 1973	Sydney Opera House	1400%
+ 2002	Federation Square (Melb)	330%
+ 2003	Athens - Olympic Stadium	\$1billion
+ 2005	Boston Central Tunnel	275%

+ Source: Flyvbjerg et al (2003a) cited by Auditor-General, Victoria (2004)

# National & International Research shows

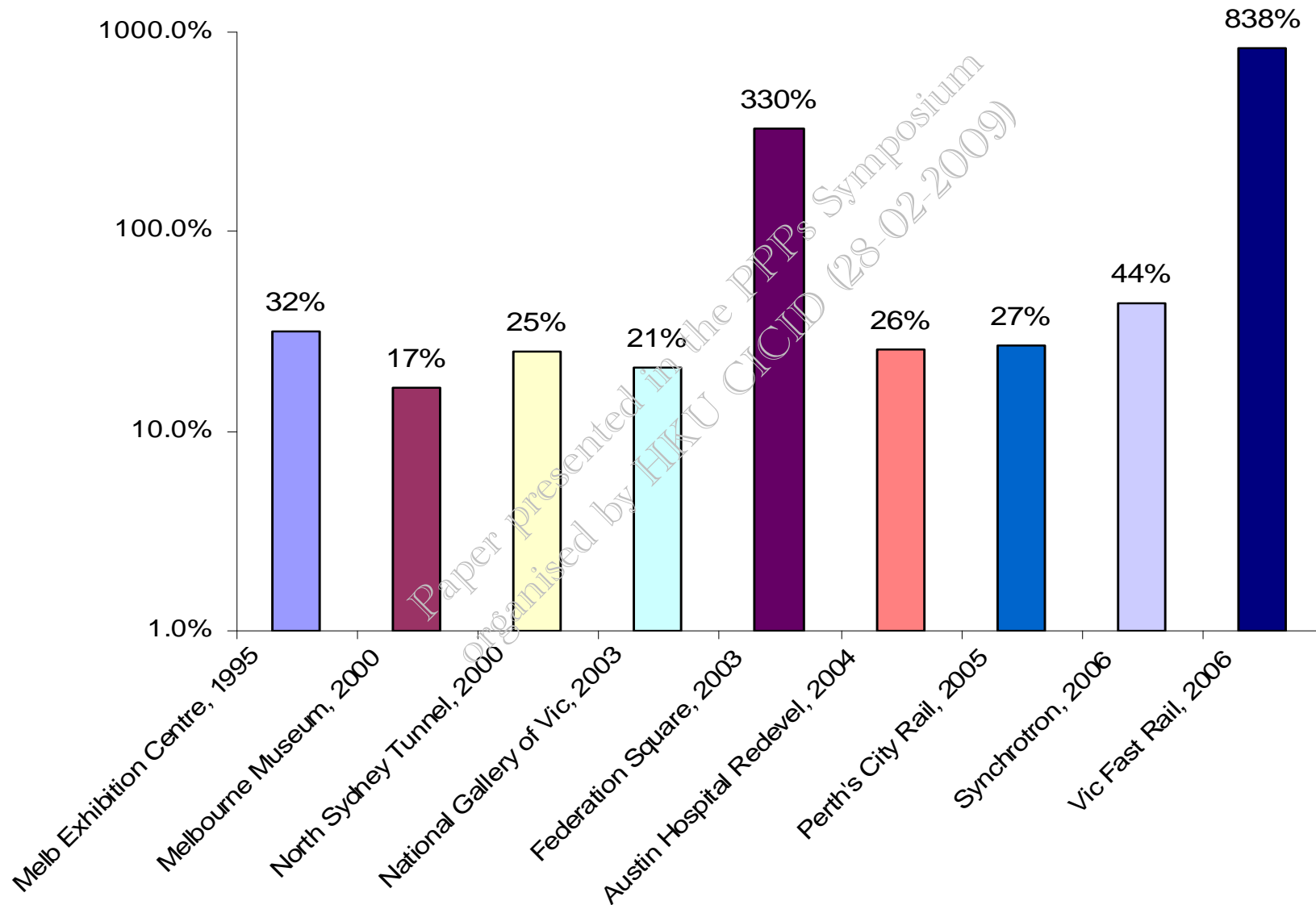


Source: Flyvbjerg et al, 2003b:82 (transport projects)

**COSTS ON MAJOR PROJECTS DO ESCALATE**

# Cost overruns on Australian projects

Closer to home ....



# Allen Consulting Group / The University of Melbourne (2007)

## TOTAL COST OF TRADITIONAL & PPP PROJECTS (\$M)

		Expected Cost	Net Cost Over-run	Final Cost	% Cost Over-run
Full Period:	Traditional	3,082.0	1,087.6	4,169.6	35.3%
Original Approval – Final	PPP	4,484.4	519.3	5,003.7	11.6%
Stage 3:	Traditional	4,532.6	672.5	5,205.1	14.8%
Contract - Final	PPP	4,946.1	57.6	5,003.7	1.2%

Source: Performance of PPPs and Traditional Procurement in Australia, Infrastructure Partners Australia Nov07

**OVERRUNS ON AVERAGE ~35%**

# Australian National PPP Forum

## Benchmarking Study (source: Duffield 2008)

Cost over-runs: Traditional and PPP projects relative to anticipated cost at the start of the period under consideration (based on averages)

	Full Period	Stage 1	Stage 2	Stage 3
No. of Observations	40	45	43	40
A. Traditional Projects	52.0%	38.2%	19.7%	18.0%
B. PPP Projects	23.8%	22.2%	7.8%	4.3%
Difference (A - B)	28.2%	16.0%	11.9%	13.7%

# Accounting for PPPs

## + Victoria's Approach:

- ✓ Partnerships Victoria Policy Statement June 2000
- ✓ Victoria's adoption of Financial Reporting Standard No. 5

## + Outstanding Issues:

- ✓ Risk/Reward Framework C/w Control
- ✓ International Financial Reporting Interpretations Committee (Interpretation 12)
- ✓ Key Issue: Risk Transfer and resulting Value for Money

# Measuring Value for Money

- + Difference between cost of PPP and the PSC (the hypothetical risk adjusted cost of Traditional delivery)
- + Is the focus only on PSC an underestimate?
- + Research Results Strongly Support This Hypothesis

# Performance of PPPs compared to traditional procurement

Research	Findings
Treasury Taskforce (2000)	Cost savings of 17% for PPPs based on 21 projects
Haskins et al (2002)	Cost savings on the PPP project's Capex component varied between 30% and 40%
Mott MacDonald (2002)	Capital expenditure resulted in: <ul style="list-style-type: none"> <li>• 1% cost overrun on average for PFI/PPP projects, and</li> <li>• 46% cost overrun for Traditional procurement projects.</li> </ul>
Fitzgerald (2004)	VFM in the order of 9% was achieved against the project's corresponding PSC.
Allen Consulting Group (2007)	Cost overruns: <ul style="list-style-type: none"> <li>• 35.3% experienced by Traditional projects, and</li> <li>• 11.6% in the case of PPPs.</li> </ul>
Duffield (2008)	Average cost overruns experienced: <ul style="list-style-type: none"> <li>• 52% by Traditional projects and</li> <li>• 23.8% by PPPs</li> </ul> <p>A difference of 28.2%.</p>

## **Additional VFM:**

### **A. Increased Scope**

#### **+ East Link Freeway:**

- Longer Tunnels
- An additional Bypass
- Additional Lanes, Enhanced noise walls, lighting, etc.

#### **+ Royal Children's Hospital:**

- Expanded food & retail operations
- Larger gross building area c/w Reference Project
- World class 'iconic' design.

## **Additional VFM:**

### **B. Public Interest Test**

- + effectiveness;
- + accountability and transparency;
- + affected individuals and communities;
- + equity;
- + consumer rights;
- + public access;
- + security; and
- + privacy.

## Alternate Structures to Current Liquidity Crisis:

- + Gov'ts guarantee debt component of PPP;
- + Gov'ts partially fund debt component on a pari-passu basis with banks;
- + Gov'ts partially fund debt component on a senior/subordinated basis with banks;
- + Gov'ts fully fund debt component as debt, or as a capital contribution leaving equity as the only form of finance.

# Conclusion: Can PPPs Continue to Deliver?

Research	Findings	Assessment
Fitzgerald (2004)	VFM in the order of 9% was achieved against the project's corresponding PSC.	✓
Mott MacDonald (2002)	Capital expenditure resulted in: <ul style="list-style-type: none"> <li>• 1% cost overrun on average for PFI/PPP projects, and</li> <li>• 46% cost overrun for Traditional procurement projects.</li> </ul>	✓✓
National Audit Office (2003)	78% of PFI Projects were delivered on budget, compared to 27% on budget for Traditional (government) procurement.	✓✓
Allen Consulting Group (2007)	Cost overruns: <ul style="list-style-type: none"> <li>• 35.3% experienced by Traditional projects, and</li> <li>• 11.6% in the case of PPPs.</li> </ul>	✓✓
Duffield (2008)	Average cost overruns experienced: <ul style="list-style-type: none"> <li>• 52% by Traditional projects and</li> <li>• 23.8% by PPPs</li> </ul> <p>A difference of 28.2%.</p>	✓✓
Standard & Poors (2007)	Of 161 survey responses, 61% believe PPPs have a better track record of delivery than Traditional procurement, 30% said ' <i>it depends</i> ' and 9% disagreed.	✓✓
Ernst & Young (2008)	In a recent report, Ernst and Young concluded that overall the projects delivered on their value promise.	✓✓
Public Interest Test	Recent PPP projects have resulted in additional outputs, whilst satisfying robust public interest tests.	✓✓

Legend: ✓ Possible, but difficult; ✓✓ Highly possible