

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

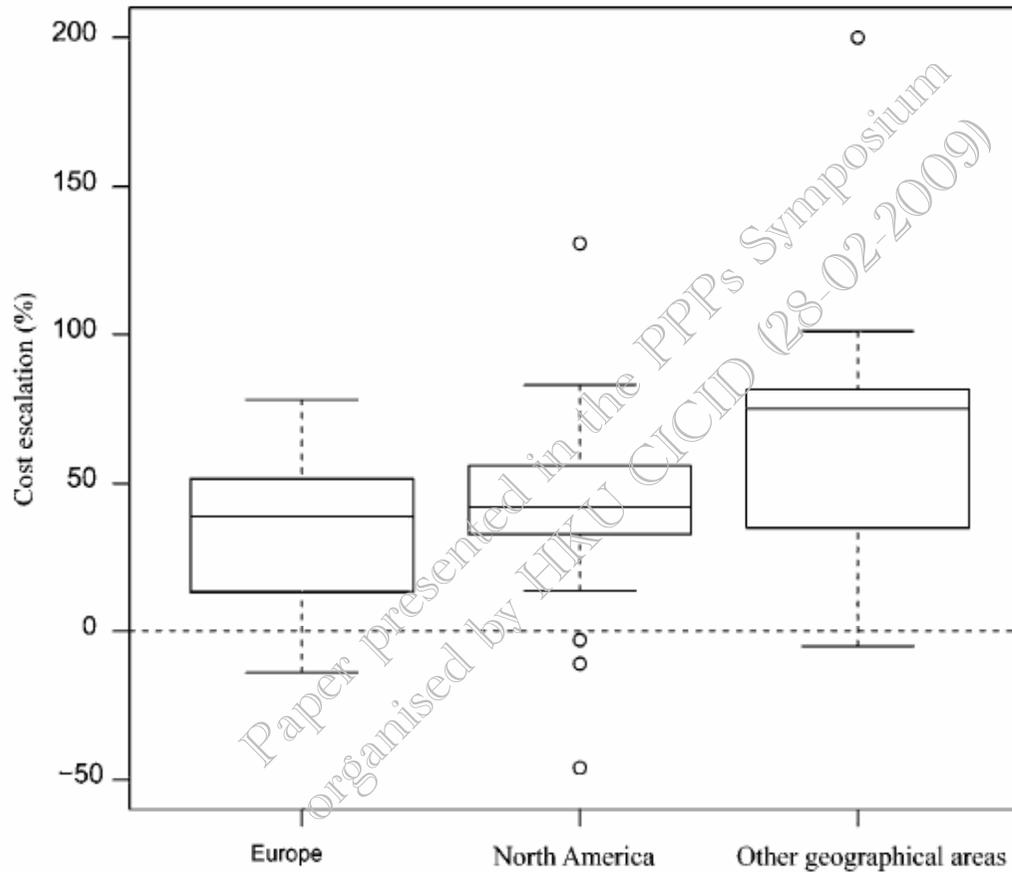
- + Perception of poor project delivery performance is reinforced by the media
- + Is National productivity and value for money being achieved?

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

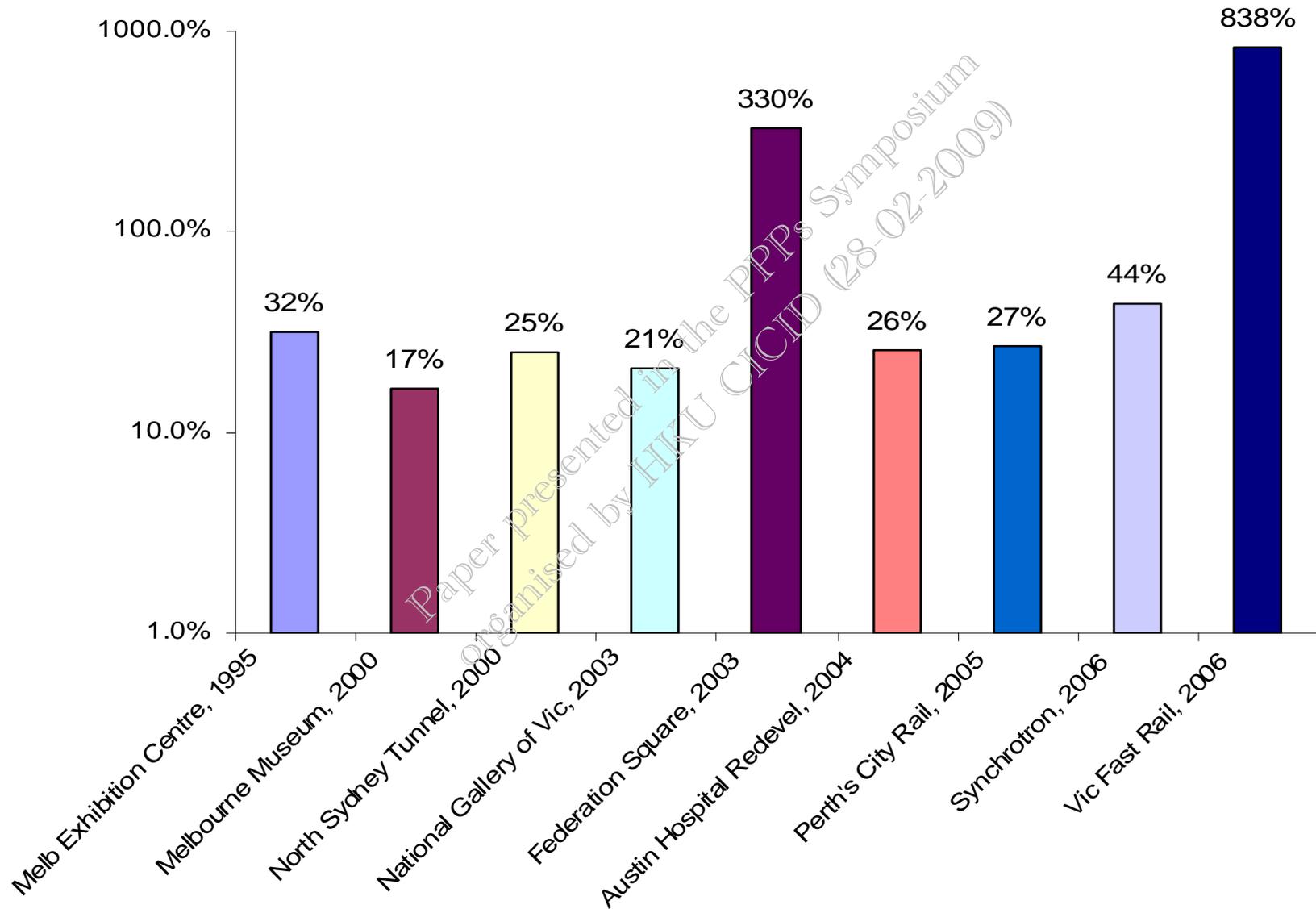


Source: Flyvbjerg et al, 2003b:82 (transport projects)

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

Paper presented in the PPPs Symposium
organised by HKU CICM (28-02-2009)

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"> • 1% cost overrun on average for PFI/PPP projects, and • 46% cost overrun for Traditional procurement projects. |
| 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"> • 35.3% experienced by Traditional projects, and • 11.6% in the case of PPPs. |
| Duffield (2008) | Average cost overruns experienced: <ul style="list-style-type: none"> • 52% by Traditional projects and • 23.8% by PPPs <p style="text-align: center;">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"> • 1% cost overrun on average for PFI/PPP projects, and • 46% cost overrun for Traditional procurement projects. | ✓✓ |
| 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"> • 35.3% experienced by Traditional projects, and • 11.6% in the case of PPPs. | ✓✓ |
| Duffield (2008) | Average cost overruns experienced: <ul style="list-style-type: none"> • 52% by Traditional projects and • 23.8% by PPPs <p style="text-align: center;">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 'it depends' 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