Small pond

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These have been a mixed few months for Australia's public private partnership (PPP) market. On the one hand, one more territory (the Northern Territory) has joined the roll call of states with firm PPP project proposals, but on the other, governmental reviews of the PPP process are underway in the two key states, New South Wales and Victoria, highlighting important shortcomings that still exist in the PPP models and procedures which have emerged to date.

The size of the Northern Territory's Darwin City Waterfront project (which will have at least some PPP characteristics), has taken many market commentators by surprise. Many sources did not believe the Territory had a large enough economy to create a PPP market. "Even grouping projects together, the Northern Territory will find it difficult to create big enough projects to merit PPP treatment," one lawyer told Project Finance, shortly before the Waterfront project was announced. But the total project cost of the Waterfront development, including a convention and exhibition center and the transformation of 25 hectares of rundown industrial land, is estimated to be A$600 million ($410 million).

Mark Upfold, a partner at Mallesons Stephen Jaques in Sydney, says that the project definition will develop through expressions of interest with the Territory seeking proposals from the private sector to meet the Territory's stated objectives. The Territory's policy framework envisages that PPP delivery can involve a number of different models, including build-own-operate-transfer (BOOT) schemes. But while the Territory has no preferred contracting strategy, a BOOT approach to the convention and exhibition centre is expected (given the Territory's recent A$1.3 billion Australasian Railway Project was also a BOOT).

The Territory has committed A$100 million to the total cost of the project itself, allowing siteworks to start almost immediately. The expressions of interest process closes on 20 October, says Upfold.

Upfold also reveals that Mallesons is acting on the project for the Territory in conjunction with the government's appointed lawyers and Darwin firm, Cridlands.

Queensland is one step ahead of the Northern Territories as bidding on the state's first PPP project, the Southbank Education and Training Precinct development, has already reached the shortlist stage. The short-listed consortia are Axiom Education, consisting of ABN Amro, Barclay Mowlem and Spotless Facilities Management; Education First, comprising Commonwealth Bank of Australia, Sodexho, Walter Construction Group, and Pradella Developments; and HubX, involving Macquarie Bank, Otis Building Technologies, and Leighton Contractors. The Southbank development is worth an estimated A$200 million.

As with almost every other PPP project in Australia to date, the tender process has been the subject of considerable criticism from the private sector due to the time and costs involved. The bidding phase for Southbank (already a lengthy one) commenced in March and may not be concluded until next year. Upfold suggests that upcoming state elections may draw out the bid process in government still further and a bid winner might not emerge until after the elections, due sometime around February 2004.

It should be worth the wait, in one respect at least, as Upfold believes that the short-listed parties in the Southbank project will be very well placed to win further infrastructure projects in Queensland. "It would not be unexpected for the

Queensland government to flex the PPP models and documentation frameworks developed in New South Wales and Victoria to suit Queensland issues. So being in the shortlist for the Southbank project will give bidders a crucial edge in understanding the Queensland approach for upcoming transactions," Upfold suggests.

From the Queensland government perspective, the Southbank project is a test of the value of the PPP approach. Alan Millhouse, partner at Allens Arthur Robinson in Brisbane, says that several other infrastructure schemes are now being screened for PPP treatment in the state.

Thus, provided Southbank gets a positive assessment, Queensland's PPP market could expand quite rapidly. The potential developments which will be next up for assessment of PPP suitability (once they have met their respective business case tests) include a A$500 million redevelopment of Ipswich, one of Queensland's major towns, and a tennis stadium and innovation park to be built in the Brisbane suburbs. Millhouse says the latter two projects are still many months away from bidding stage. Both are expected to be worth over A$100 million. Although many observers do not class roads projects as real PPP projects, a major Brisbane roads development, the Gateway Bridge duplication and motorway deviation project, is also being considered for PPP status.

As their PPP programs start to take shape, the governments in the Northern Territory and Queensland will be taking note of the level of private sector dissatisfaction with the PPP initiatives in New South Wales and Victoria.

Underscoring the level of private sector frustration, one company, part of Leighton Holdings, was said to be so upset by the costs involved in the recent tendering for the Partnerships Victoria Correctional Facilities project that it withdrew its bid and subsequently stated it would no longer pursue PPP opportunities.

The costs involved in bidding for the prisons project were not exceptional to the Australian market, says Jeremy Brasington, director, global structured finance, at ANZ Investment Bank. "One reason bid costs are so high for PPP projects is government is only prepared to award a mandate after it has negotiated with bidders in very fine detail." Brasington says the Victorian government took two bidders into the detailed documentation stage for the Spencer Street Station development and the Berwick Community Hospital and Correctional Facilities projects. "Neither the Berwick Hospital or prisons project is particularly large," says the banker.

Both New South Wales and Victoria are currently reviewing their PPP programs. Government sources say the Victorian review, which was announced in late August has been launched simply because it has been three years since the Partnerships Victoria project was released, not due to any specific private sector criticisms.

Brasington and Millhouse note that the Victorian review is aimed at refining the PPP approach. "Much of the focus will be on risk assessment to reflect the fact that the PPP market has moved on since the initial PPP deals," says Millhouse. Other key areas for review are the public interest test, the public sector comparator and quality assurance measures. A draft report of the Victorian review is to be published in November. Interested parties will then be invited to provide submissions are a final report is scheduled to be presented to the Treasurer in December.

The NSW review includes a reassessment of capital works procurement generally. Millhouse says the review will potentially include changes to the model for encouraging private sector involvement in public works and will also look at ways to build a clearer and more accountable PPP system in government. "Apart from issues related to tendering, the private sector wants to see an improved mechanism for capturing experience gleaned from current and past PPP projects and better government coordination of the whole PPP initiative," says the lawyer. The NSW review is already underway but recommendations have not yet been made public.

In the meantime, the small size of the PPP market in Australia has created a Catch-22 situation for the private sector. Compared to the PFI market in the UK, there are too few upcoming PPP developments in Australia for private sector companies to believe that they have a good chance of winning a reasonable proportion of upcoming projects, says Brasington. "Companies would be more willing to bear the tender costs if they thought their chances of getting into the market were better," he comments. The UK's 'cookie-cutter' approach (whereby the government would try to ensure that all bidders eventually get their fair share of the market), is not replicated in Australia, both because of the limited number of projects mandated to date, and because of the division of the PPP market along state lines.

Some observers suggest the unwillingness of government to include service delivery in with property construction and development and basic maintenance has held back market development by reducing overall project size and scope for private sector efficiencies. "The government and private sector both talk of a minimum deal size, below which PPP treatment wouldn't make sense," says Richard Cooper, director, project finance at National Australia Bank (NAB). Largely because of the costs involved in a PPP tender, A$100 million is a common rule of thumb, for minimum economic size, says Cooper. "But it does depend very much on the complexity of the project," he adds.

Peter Clark, domestic head of project finance at Citibank says: "this is a fundamental issue as it reduces the amount of added-value that the private sector bring to the table and the potential size of each PPP project," he adds. "One might think that the Victorian and New South Wales governments would now be comfortable enough with the PPP concept to consider including service delivery in the tender package, but this has not happened in any recent deal," says Cooper, "no doubt because government is very sensitive to public opinion on this issue."

Similarly, state governments continue to restrict co-use of dedicated facilities (for example, the school buildings in the New South Wales schools project won by the Axiom Education consortium). "So far, no PPP project has seen co-use of core infrastructure. Government tends to provide incentives to the private sector in the form of collateral property development, as happened in the A$700 million Spencer St Station project," says Brasington. Provided the project gets the go-ahead, the New South Wales government is also expected to set aside land for commercial development in the mooted NWS Parramatta district court project.

Despite the PPP market's obvious growing pains, the financial sector continues to develop its PPP skills base. Westpac established its PPP unit in March, within its specialized capital group. Commonwealth Bank, Macquarie Bank, and ANZ Investment Bank all have PPP teams. Brasington says ANZ's PPP unit was formally established this year, although the bank's involvement in the PPP market extends back to participation in the bid stages of the very first PPP deals.

The remaining major indigenous bank, NAB, has not set up a specific PPP team. "But we already have considerable PPP experience in our project finance unit," says Cooper. Foreign banks, notably ABN Amro, have hired PPP specialists and Royal Bank of Scotland and Bank of Scotland have both brought in dedicated PPP personnel from the UK. "Even if the market is stuttering at the moment most banks recognize the potential importance of the PPP approach to the overall infrastructure finance market," says Brasington.

Interest in PPP may be spread across the banking market at large, but so far the lion's share of the most important PPP mandates has gone to ABN Amro. Market sources suggest several major reasons for this success, including the bank's bond market expertise. But perhaps the key success factor has been the bank's willingness to act as a one stop shop: as a financier, an equity provider and debt arranger. "Government is keen on that idea," says a rival banker, "as they have a better idea of who they should really be talking to as the project develops." ABN Amro's central role also allows more flexibility in creating a competitive package. "If, for instance, they don't propose the lowest cost of finance, they will at least have the flexibility to offer more favourable terms in other aspects of the overall project bid," the financier adds.

It is noteworthy that an ABN Amro-backed consortium did not win the latest PPP mandate awarded, for the Victorian prisons project. On 21 August, the Victorian government announced that the bidding had been won by a consortium including Bilfinger Berger, Baulderstone Hornibrook and United KG.

It is an open secret that Baulderstone was very anxious to win its first PPP contract. Therefore the bid is thought to have been particularly aggressive. Unusually, the financial adviser (NM Rothschild) has also put forward two funding options and the government will decide which offers the better profile for them. Bank of Scotland has proposed to finance the bid with a bank debt package. Westpac is proposing a debt capital markets alternative.

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