

Wiri Prison PPP, New Zealand - IJ Awards 2013 Social Infrastructure deal of the year

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New Zealand is not considered to be a mature PPP market, but if there is political will it is likely to catch up quickly given its status as a rich country and its proximity to the larger and relatively more experienced Australian market, from which New Zealand can draw advisory and other resources readily.

The NZ\$690 million Wiri Prison PPP was not the first PPP to close in the country, but has the potential to resonate far beyond the Hobsonville Point Schools PPP in Auckland, which reached a financial close earlier in 2012, and was the first PPP to do so.

Hobsonville Point weighed in at just US\$98 million and had just a single lender. It reached a financial close within a year of expressions of interest being offered.

The Wiri Prison PPP by contrast was worth more than three times as much and involved different banks offering different amounts of debt across different tranches.

Meanwhile, the government was clear that it wanted the Wiri PPP to be a pathfinder for the space. It was an opportunity for the government to take a “first principles” approach and map out a distinctive path for the country’s PPP sector as opposed to leaning too heavily on precedent from Australia, the UK or anywhere else.

The project

Before the procurement of the prison began, the New Zealand government was looking for projects suitable for piloting the PPP model. It wanted a greenfield project of more than NZ\$100 million with a concession length of 25 or 30 years. There needed to be the ability to transfer risk to the private sector, and to generate innovation in return.

In mid-2010, the prison, which would be a new men’s jail with 960 seats, was settled on as a suitable pilot. There was a particular belief that there would be scope for innovation within the delivery of the project, which was part of the project’s attraction to the government.

Ancillary buildings are included within the scope. The site is about 25km southeast of the central business district of Auckland. The selection process kicked off in November 2010 and lasted 20 months.

It was won by the SecureFuture consortium, which comprises Serco Australia, Fletcher Construction, Spotless Services, ACC and John Laing Investments. SecureFuture was named as preferred bidder in March 2012, beating the other final contender led by G4S and Leighton Contractors.

SecureFuture would design, finance, build, operate and maintain the new facility with a strong focus on rehabilitation and reintegration of offenders. The prison was expected to meet growing demand for prisoner accommodation in

Auckland. Fletcher Construction was to build the new prison, and it will be operated by Serco and maintained by Spotless Facility Services.

The selection process was followed by a six-month negotiation period, which saw the eventual contract differing from the draft which had been made public previously. The length of the concession was 25 years, and the total value of debt and equity was NZ\$840 million. This was supposed to be 17 per cent less than the prison would have cost under conventional procurement, according to the country's prisons minister.

The finance

Financial close was accomplished on 10 September 2012. The SecureFuture consortium provided equity of NZ\$67 million. Each consortium partner supplied approximately 30 per cent of the equity, with 10 per cent from Serco.

The following lenders provided NZ\$335 million of debt across two non-concurrent tranches:

- ANZ
- Bank of New Zealand
- BOS International (Australia)

ANZ and Bank of New Zealand each provided NZ\$134 million, while BOS International provided NZ\$67 million. All three banks acted as Mandated Lead Arranger.

The debt took the form of a construction facility for the three-year construction period, after which a further NZ\$335 million term loan with a four year tenor will kick in.

ANZ acted as facility agent, security trustee and account bank.

"Despite a majority of the funding coming from financiers which had not previously funded a project involving custodial operations risk, a rigorous due diligence process enabled unconditional underwriting commitments at bid date and ultimately funding at financial close," the bank stated.

"This funding structure package was robustly structured to deal with the increased risk profile as a consequence of the greater operational leverage than typical Australian infrastructure PPPs."

Allen & Overy and Corr Chambers Westgarth worked alongside local firm Bell Gully to provide legal counsel to the authority, while PwC acted as financial adviser.

The contract

The payment mechanism was based on availability but had performance aspects. Services below required performance levels would result in reduced payment, charges would be levied for serious failures, and there was an incentive payment for achievement of ultimate outcomes.

This is seen to be more sophisticated than a standard payment-by-results type of model familiar to the UK market for example. The brief from the Department of Corrections was that the prison must address particular problem areas in the justice system such as high recidivism rates on the part of Maori and Pacific Island inmates, through innovative risk allocation, and the sponsor was incentivised specifically to deal with this.

On the other hand, the Department gave no design brief to the sponsors and this was seen as a way of giving maximum leeway for the private sector to come up with innovative solutions.

There are other differences between the emerging New Zealand model, based on the Wiri contract, and the UK and Australia.

The contract infers an effective veto by the government on refinancings, even down to the level of the timings of a

transaction, the length of the tenor, the prescription of financial ratios and a methodology for swap break costs.

The New Zealand government has also done away with a theoretical fair value concept, which would arise in the case of termination with existing contractors.

While in the UK it is the case that a sufficient number of parties being willing to bid is taken to ensure against spuriously low bids, in New Zealand there is a requirement that at least three parties which meet pre-qualification criteria intend to participate.

Another interesting aspect was the tax treatment of the project. SecureFuture was advised by KPMG in this regard. The project secured a Private Binding Ruling from the country's Inland Revenue, which KPMG described as "professionally challenging". The Hobsonville project attained no such ruling. However, it was important for the sponsors to attain a ruling as it would provide certainty, over life of the concession, of the project's tax treatment. The private binding ruling and special determination covered the treatment of key items of expenditure and income for the project.

The future

With the pathfinder Wiri Prison PPP now out of the way, the Transmission Gully PPP project is currently the focus of the PPP market in New Zealand. However, other projects to have received consideration are:

- the Whole of Government Radio Network
- the Clifford Bay Ferry Port
- the Waikato Expressway
- the Christchurch justice sector hub
- Middlemore Hospital

To what extent the Wiri Prison documentation is used as a base for new projects in the PPP sector will be key indicator of its importance. With the shortlist having been announced for the Transmission Gully PPP this week, and particularly considering it is dividing the political parties in New Zealand (with the National Party in favour and the Green Party and Labour Party against) the robustness of the procurement and the ability of the contract to stand up to public scrutiny will be severely tested.

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