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Public Private Partnerships: Business Case Development



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Public Private Partnerships:
Business Case Development

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Asset Management Group

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The Financial Management Guidance series of publications

- No. 1 *Commonwealth Procurement Guidelines*, January 2005.
- No. 2 *Australian Government Foreign Exchange Risk Management Guidelines*, September 2006.
- No. 3 *Guidance on Confidentiality of Contractors' Commercial Information*, February 2003.
- No. 4 *Australian Government Cost Recovery Guidelines*, July 2005.
- No. 5 *Guidelines for Implementation of Administrative Arrangements Orders and Other Machinery of Government Changes*, September 2003.
- No. 6 *Guidelines for Issuing and Managing Indemnities, Guarantees, Warranties and Letters of Comfort*, September 2003.
- No. 7 *Guidelines for the Management of Special Accounts*, October 2003.
- No. 8 *Guidance on the Listing of Contract Details on the Internet (Meeting the Senate Order on Department and Agency Contracts)*, January 2004.
- No. 9 *Australian Government Competitive Neutrality Guidelines for Managers*, February 2004.
- No. 10 *Guidance on Complying with Legislation and Government Policy in Procurement*, January 2005.
- No. 11 *The Role of the CFO – Guidance for Commonwealth Agencies*, April 2003.
- No. 12 *Guidance on Identifying Consultancies for Annual Reporting Purposes*, July 2004.
- No. 13 *Guidance on the Mandatory Procurement Procedures*, January 2005.
- No. 14 *Guidance on Ethics and Probity in Government Procurement*, January 2005.
- No. 15 *Guidance on Procurement Publishing Obligations*, January 2005.
- No. 16 *Introductory Guide to Public Private Partnerships*, December 2006.
- No. 17 *Public Private Partnerships: Business Case Development*, December 2006.
- No. 18 *Public Private Partnerships: Risk Management*, December 2006.
- No. 19 *Public Private Partnerships: Contract Management*, December 2006.
- No. 20 *Guidance on the Gateway Review Process – A Project Assurance Methodology for the Australian Government*, August 2006.
- No. 21 *Australian Government Policy Principles for the Use of Public Private Partnerships*, December 2006.

The Financial Management Reference series of publications

- No.1 *List of Australian Government Bodies and Governance Relationships as at 31 December 2004*, December 2005.
- No. 2 *Governance Arrangements for Australian Government Bodies*, August 2005.
- No. 3 *Financial Management and Accountability Legislation*, October 2005.
- No. 4 *Commonwealth Authorities and Companies Legislation*, February 2006.
- No. 5 *Introduction to Cost-Benefit Analysis and Alternative Evaluation Methodologies*, January 2006.
- No. 6 *Handbook of Cost-Benefit Analysis*, January 2006.
- No. 7 *Gateway Review Process – A Handbook for Conducting Gateway Reviews*, August 2006.

Foreword by the Parliamentary Secretary

Internationally there is an increasing trend for governments to involve the private sector in major infrastructure and equipment projects with some positive results and benefits being achieved.

As part of its drive to address the important question of how best to meet infrastructure needs across the country the Australian Government, through the Department of Finance and Administration (Finance), has developed the *Australian Government Policy Principles for the Use of Public Private Partnerships* (the PPP Principles) so, where appropriate, partnership opportunities can be harnessed to achieve the best possible results for the community.



The PPP Principles give agencies a framework to ensure a realistic approach to analysing procurement options. The framework is also flexible enough to help agencies deal with the wide variety of projects they may have to consider.

With the help of a number of other organisations and agencies, Finance has produced a series of guides to help government agencies decide whether Public Private Partnerships (PPPs) are appropriate for particular projects. These guides are practical, useable, and as far as possible, consistent with the approach used elsewhere in Australia.

This publication guides agencies through the assessment and approval process needed to determine best value for money and also guides them in how to prepare a recommendation seeking government support.

Other publications in the series of guides on PPPs include:

- *Introductory Guide to Public Private Partnerships;*
- *Public Private Partnerships: Risk Management; and*
- *Public Private Partnerships: Contract Management.*

I commend the publication to you.

A handwritten signature in black ink that reads "Richard Colbeck". The signature is written in a cursive style with a long horizontal stroke at the end.

Senator the Hon Richard Colbeck

Parliamentary Secretary to the Minister for Finance and Administration

Acknowledgments

The Department of Finance and Administration would like to express its appreciation to the following organisations and individuals who took the time to provide valuable feedback and input to this and other guides in the PPP policy framework:

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- Commonwealth Bank of Australia (through AusCID)
- Directorate of Private Financing and Commercial Support, Department of Defence
- DMV Consulting
- Macquarie Bank (through AusCID)
- Minter Ellison (through AusCID)
- New South Wales Department of Treasury
- Queensland Department of State Development
- South Australia Department of Treasury and Finance
- Victorian Department of Treasury and Finance
- Western Australia Department of Treasury

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Introduction 1

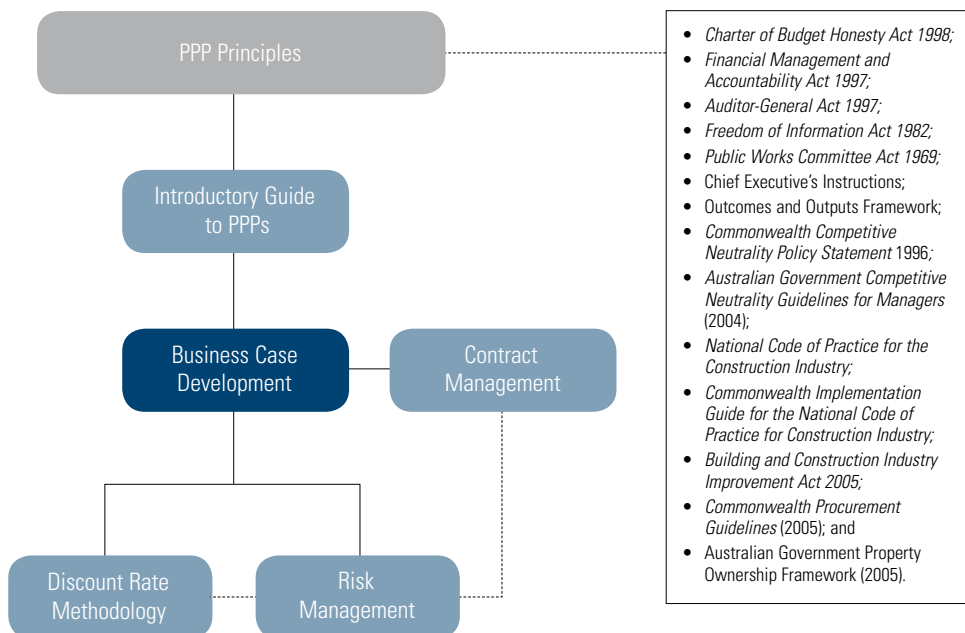
The aim of this guide is to provide practical advice on the steps involved in compiling a business case for a Public Private Partnerships (PPP) project in line with the *Australian Government Policy Principles for the Use of Public Private Partnerships* (the PPP Principles). The PPP Principles apply to all Australian Government agencies subject to the *Financial Management and Accountability Act 1997* (agencies).

The Australian Government's objectives in establishing the PPP Principles are to:

- provide agencies with a policy and process to develop a PPP proposal and assess the relative merits of a PPP arrangement in comparison with other delivery options; and
- help ensure effective and responsible allocation of its resources and sound fiscal management.

This guide is one of several guidance papers developed and issued by the PPP Unit within the Department of Finance and Administration (Finance). An overview of the set of papers available and the relationships between the individual papers is given in Figure 1.

Figure 1: PPP Principles and Guidance Framework



1 Introduction

If a PPP arrangement is being considered, this guide will assist an agency to critically assess the value for money of a PPP option compared to a traditional (government funded and managed) or other delivery option. Evaluation of PPP and other methods of procurement also require risk analysis and management. *Public Private Partnerships: Risk Management* is available to provide specific advice on this aspect of the business case.

Finance will aim to keep agencies informed and up to date by the release of further advice as needed. All documentation will be available from Finance's website at www.finance.gov.au.

Executive Summary 2

Value for money is the core principle governing Australian Government procurement. This guide is a reference tool for those Australian Government agencies considering the delivery of infrastructure and related service requirements through a PPP arrangement. Achieving value for money is a fundamental prerequisite for a PPP project. It is the key measure that must be demonstrated to secure government approval to take the project forward as a PPP project.

The PPP Project Life Cycle has been mapped to identify the critical stages in project development and in securing government approval. A project management development framework has been provided for documenting and reporting on the project's progress. The approval process outlined in this guide represents how a typical project might obtain the necessary authorisation from government to proceed with a PPP procurement. However, the circumstances of individual projects vary enormously, so agencies are strongly advised to approach the PPP Unit in Finance to discuss the procedures that apply and where these may need tailoring to suit individual project circumstances.

To secure government approval, a potential PPP project must demonstrate value for money over alternative delivery options. This involves the following steps:

- initial identification of an output requirement and the project scope to meet this requirement;
- identification and initial assessment of delivery options;
- assessment and valuation of project risks for inclusion in financial models of both PPP and alternative public sector delivery methods;
- quantitative and qualitative comparison of delivery options to determine which provides the best value for money to government;
- subject to receiving government approval to proceed, confirmation of the value for money assessment using tender quality information obtained by engaging with the market through Expressions of Interest (EOI) and Request for Tender (RFT) processes; and
- selection of a preferred tenderer, and subject to government approval, negotiation of a final contract and contract delivery.

This process will produce key project management documents, which include a Scoping Study, Interim and Final Business Cases as well as tender documentation and submissions to government.

This guide works through the project development framework by describing the key elements of each stage and outlining the assessment process that governs the project's progress.

3 Overview

3.1 Purpose

This guide works through each stage of a PPP Project's Life Cycle, discussing the key deliverables needed to support project development. This guide should be read in conjunction with the Commonwealth Procurement Guidelines (CPGs), the PPP Principles as well as other guidance issued by the Finance on PPP and procurement policy.

The purpose of this guide is to:

- introduce and detail the steps of progression through each of the three stages of a PPP project's life cycle these being: Stage 1 – Project Strategy; Stage 2 – Project Options; and Stage 3 – Project Delivery;
- provide a business case framework to document and report a PPP project's development;
- ensure accountability and transparency in identifying the delivery option that provides the best value for money outcome;
- ensure that sufficient information is provided to government to secure commitment to the best value for money delivery option; and
- establish a basis for evaluation and management during each stage of the project's life cycle.

3.2 Procurement Obligations

3.2.1 Approvals Required

Financial Management and Accountability Act 1997

The *Financial Management and Accountability Act 1997* (FMA Act) and the associated *Financial Management and Accountability Regulations 1997* (FMA Regulations) set down a number of legal obligations which must be followed by officials involved in procuring any property and services for the Australian Government.

FMA Regulation 8(1) requires officials to have regard to the CPGs when conducting procurement processes. FMA Regulation 9 requires an Approver (an official with the delegated power to do so) to be satisfied amongst other things that the proposed expenditure is in accordance with the policies of the Australian Government and will make efficient and effective use of public money. FMA Regulation 10 approval will also as a rule be required for PPP arrangements due to their long durations.

PPP Principles

In addition to meeting the FMA approval requirements that relate to any procurement, there is the obligation to adhere to the approval requirements that apply to PPP projects.

The following approvals are required, depending on the replacement value of the asset involved in the project:

Asset replacement value	Approval required
Below \$20 million	Agency Chief Executive
\$20 million or more but below \$50 million	Minister for Finance and Administration
\$50 million or more	Full government

Where a project is less than \$20 million, but has the potential to significantly limit or impact on an agency's future activity or the government's fiscal position, approval by the Minister for Finance and Administration is required.

3.2.2 Commonwealth Procurement Guidelines

The Minister for Finance and Administration issues the CPGs under FMA Regulation 7 about matters relating to the procurement of any property and services. According to the CPGs, value for money is the core principle governing all Australian Government procurement.

A full copy of the CPGs can be obtained through the Finance's website at www.finance.gov.au.

3.2.3 Requirement for Probity Process

A probity process ensures that ethical conduct has been maintained throughout the procurement process and that the core policies of the Australian Government, as contained in the CPGs, other legislation and the departmental Chief Executive's Instructions, have been complied with.

Depending on the size and complexity of a PPP project, it may be worthwhile engaging an independent probity adviser to provide advice on all tender documentation as well as evaluation methodologies and process.

Detailed guidance on probity matters is available in the Finance publication *Guidance on Ethics and Probity in Government Procurement*¹.

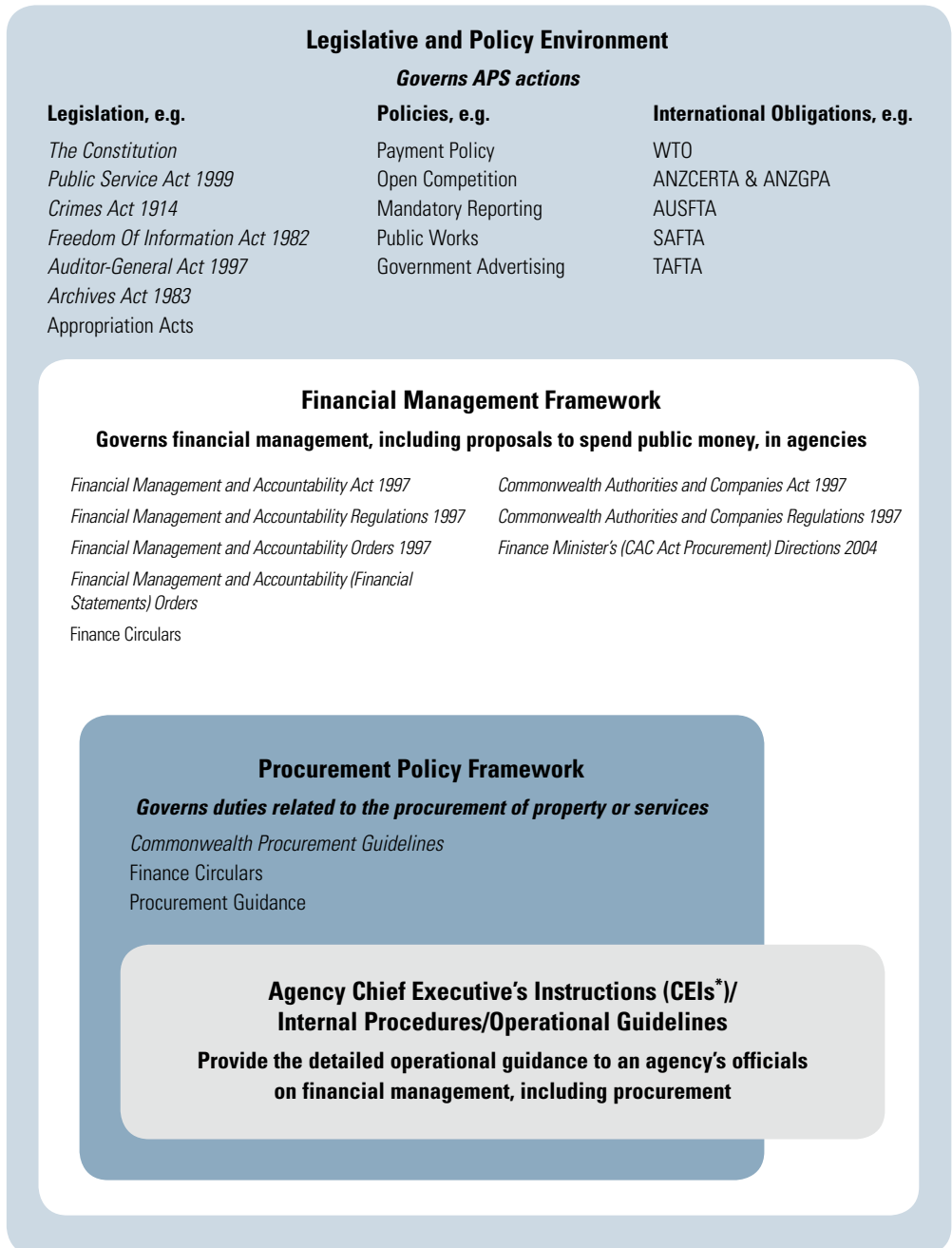
3.2.4 Procurement Policy Environment

The overall environment for Australian Government procurement is set out in Figure 2. It consists of relevant legislation and government policy, the financial management framework governing the management of government resources, and the procurement policy framework containing the detailed policies and guidelines relating to procurement.

¹ Department of Finance and Administration, 2005, *Guidance on Ethics and Probity in Government Procurement*.

3 Overview

Figure 2: Procurement Policy Environment



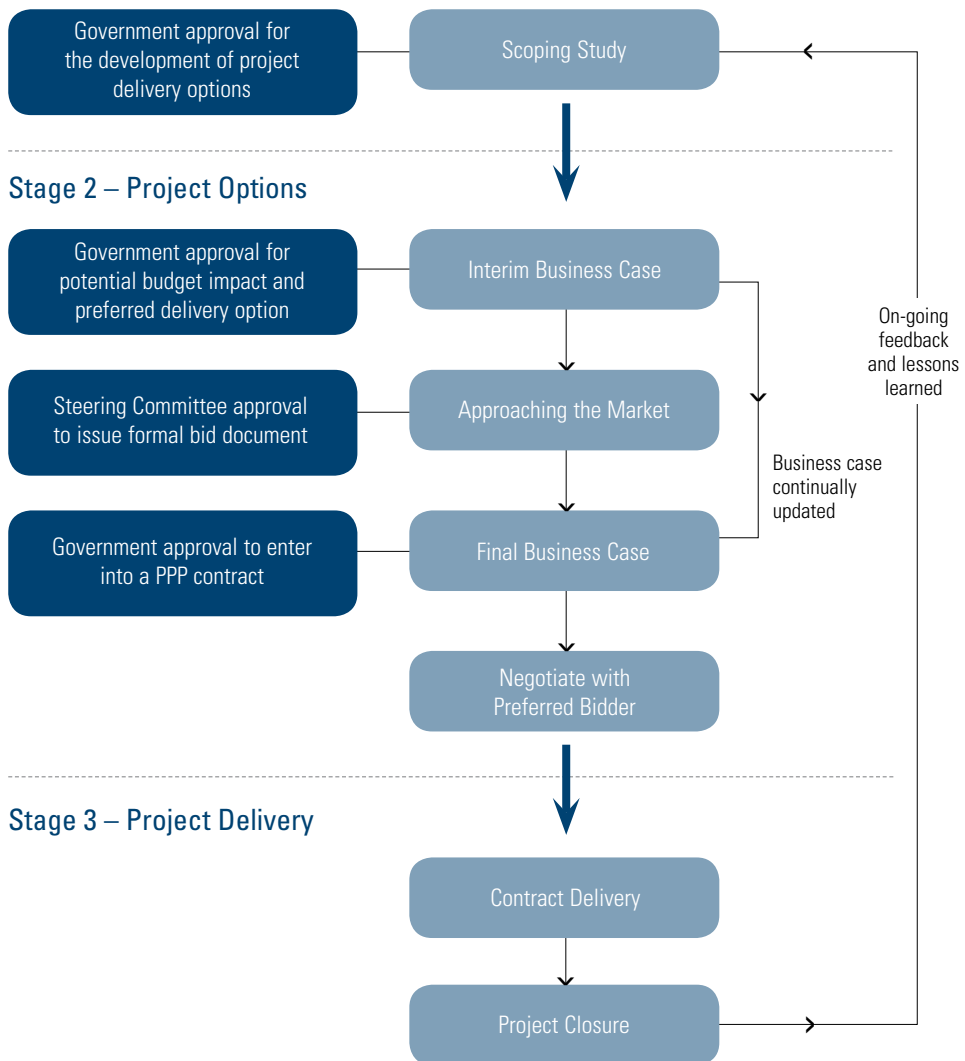
* Chief Executive's Instructions build on the procurement and financial management frameworks and the policy and legislative environment and provide operational guidance focussing on the agency's particular needs.

Process Map 4

The following diagram presents the three stages of development in a PPP Project's Life Cycle. This guide focuses on the first two stages of the PPP Project Life Cycle: Stage 1 Project Strategy; and Stage 2 Project Options.

Figure 3: PPP Project Life Cycle

Stage 1 – Project Strategy



4 Process Map

4.1 PPP Project Development

This guide focuses on the stages of project management for a PPP project proposal. A table of key tasks to be completed at each stage is provided in Appendix D.

4.1.1 Stage 1 – Project Strategy

To establish the need for the project and determine the full range of delivery options available for project delivery, it is recommended that the agency conduct a Scoping Study (see Section 5).

4.1.2 Stage 2 – Project Options

Once the need for the project and potential delivery options have been identified (and assuming a PPP is a feasible option), the best value for money option needs to be confirmed. This is done through a five step process, being:

- Interim Business Case (see Section 6);
- Approaching the market (see Sections 7 and 8);
- Final Business Case (see Section 9); and
- Negotiations with Preferred Tenderer (see Section 10).

Progression through each step will involve consultation between the agency, government and the private sector and is dependent upon the value for money outcomes of the previous step and in some cases, dependent on achieving government support for that value for money conclusion.

4.1.3 Stage 3 – Project Delivery

Approval of PPP as the preferred delivery option and successful contract finalisation will then require ongoing contract management based on a formal contract management structure that oversees contract performance and change management. Section 11 provides a summary of these issues, which are further defined in *Public Private Partnerships: Contract Management*.

4.1.4 Establish the Project Management Structure

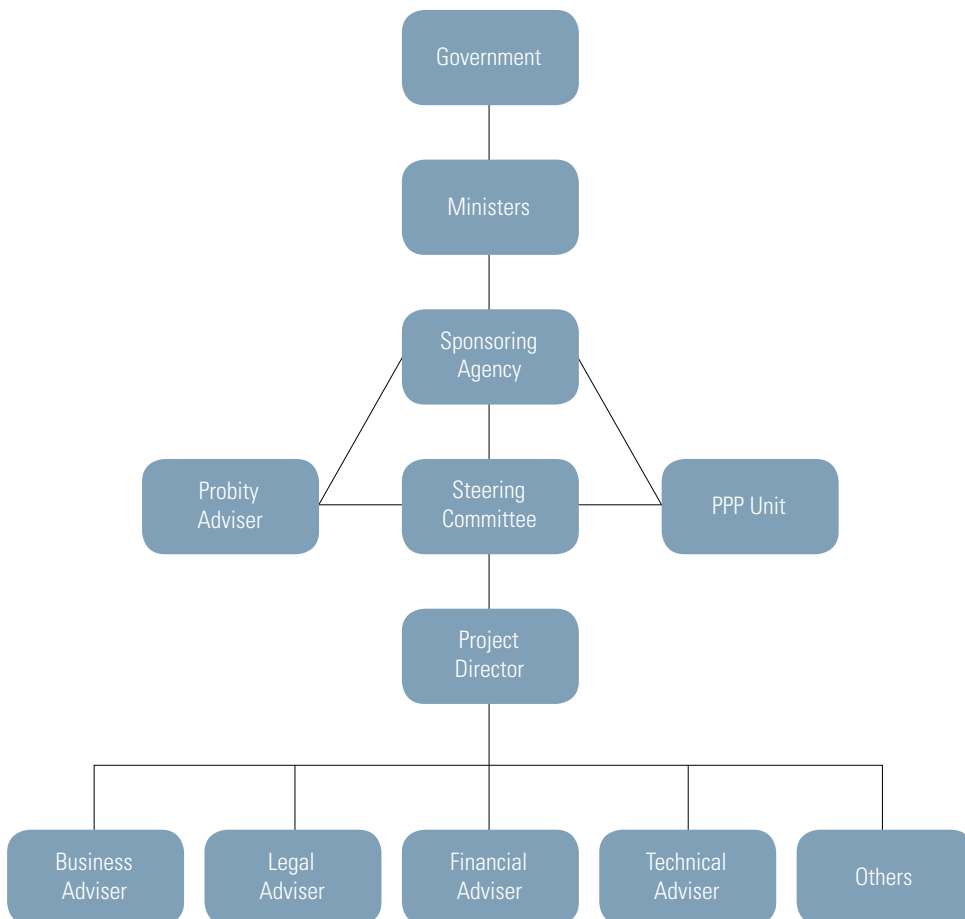
The management structure of a PPP project is shown below in Figure 4. A stable and dedicated project team should be established and a core element of staff retained throughout the assessment and implementation stages. Stability of the project management team is widely recognised as a key element of a successful project. The key roles within the management structure are:

- the Project Steering Committee, which provides direction and has ultimate accountability for a project; and

Process Map 4

- the Project Director, who is responsible for delivery of the project and for the management of the procurement team. The specialist expertise required within the procurement team will vary from project to project. It will be partly sourced from within government, and partly from external consultants. Due to the key role of the Project Director, the position is normally assumed on a full-time basis.

Figure 4: Typical PPP Project Management Structure



4 Process Map

While support from external specialists will generally be required in some capacity, developing strong in-house skills will accelerate the project process timetable, build the public sector's practical knowledge base and promote the benefits and effective application of the PPP Principles.

4.1.5 The PPP Advisory Services Panel

To assist agencies in seeking accredited advisers, Finance has established a PPP Advisory Services Panel that is available to all Australian Government agencies. The specialist advisers represented on this panel have expertise in PPP projects in areas such as strategic business advice, commercial and financial advice, accounting and taxation advice and risk analysis and management. Legal services are not provided for in this panel, and are normally available through each agency's individual arrangements.

Agencies wishing to use the services of the panel are required to sign a Memorandum of Understanding (MoU) with Finance. Agencies are encouraged to access the specialist skills available from the panel and are advised to approach the PPP Unit to obtain advice on establishing a MoU and other aspects of using the services of the panel.

Stage 1

Project Strategy

5 Scoping Study

5.1 Function

The Scoping Study describes how the project meets the strategic aims and stated outputs of government. It outlines and provides an initial assessment of the available delivery options for the project. For the purposes of this guide a PPP approach is assumed to have been assessed as a feasible option.

Users of this guide should note that if at this stage it is decided that a PPP is not suitable, they should revert to the normal Budget process for capital proposals.

5.2 Framework

The **key steps** of the Scoping Study are:

- identify what services and assets are required to achieve the project objectives;
- establish project scope; and
- outline delivery options.

5.2.1 Identify Service Need and Project Objectives

Consideration of an infrastructure project requires an output requirement to exist. Service needs are often identified through well-established planning and strategy reviews and often arise in order to meet community service obligations. The drivers for a project's objective may be either:

- internal, e.g. replacement of an obsolescent asset, new product/service or business as a result of government policy; or
- external, e.g. legislation, or improved new technology.

5.2.2 Establish Project Scope

The project scope is a summary of how the infrastructure project fits within any wider government program, as well as the agency's outcomes, organisational structure, key responsibilities and investment strategy (see section 6.2.2 for further detail on refining scope).

5.2.3 Identify Key Stakeholders

Key stakeholders will generally include the agency's employees, other government organisations and affected community groups. The potential impact of the project on each stakeholder needs to be carefully considered, in particular with regard to major risks that could threaten the successful implementation of the project. Consultation with external stakeholders may, however, not be possible at this stage, as government approval has not yet been obtained.

5.2.4 Outline Delivery Options

Once the project scope has been outlined it is possible to broadly consider the possible delivery options. This will involve consideration of the technical requirements involved in achieving service delivery. Delivery may be through a range of delivery options involving varying operational, financial and ownership elements.

Being the initial phase in considering service and delivery options, it is important to include a range of realistic and innovative options, which may be based on:

- existing asset utilisation;
- new asset requirement; and
- non-asset solutions, e.g. changes to the current service delivery model.

Whole-of-life Costs

An initial assessment of possible delivery options should include estimates of whole-of-life costs, such as:

- initial capital expenditure, including costs that may be borne directly by the agency and those borne by any private contractors (e.g. IT infrastructure costs);
- life cycle maintenance and refurbishment costs;
- operational costs; and
- cost of any necessary associated infrastructure, e.g. access roads to a new building, or maintenance facilities for new equipment.

Different delivery options are likely to have different budget impacts and so the above cost assumptions should also be examined to determine the funding needs over the project's life cycle. Cost should be compared on a like for like basis (e.g. same term, same quality) to ensure that delivery options are comparable.

Risk Analysis

All major risks associated with each possible delivery option should be identified. This should include identification of key risks and their likely allocation between public and private sectors under the identified options and an indication of which risks are likely to result in a value for money outcome when transferred under a PPP approach. The aim is to initiate the risk management process, even though it is highly likely that as the project develops and more detailed information becomes available these risks, and their priority, will change. Further guidance is available from *Public Private Partnerships: Risk Management*.

Constraints

There should be identification of constraints for each possible delivery option. It is not necessary to try to resolve these concerns at this stage, but rather to identify and determine the impact of each. This may include:

5 Scoping Study

- internal constraints, e.g. employment, funding levels, existing contractual obligations; or
- external constraints, e.g. public interest, legislation, environment, native title, planning, supplier issues or market development.

5.2.5 *Submission to Government*

The outcome of the Scoping Study should be a defined service requirement and a range of possible delivery options, which will in most cases be reported in a submission to government. In reality not every potential delivery option will require the same level of assessment, with most options being eliminated early on. The possible options put forward should be kept to a minimum, in general being two or three.

In assessing whether a PPP approach is viable, agencies should refer to Appendix B – PPP Suitability Checklist. This assessment also forms part of the Interim Business Case that is put forward to government – section 6.2.7 refers. If a PPP is a recommended option then the processes to achieve government approval as outlined in this guide will need to be followed. Standard budget approval processes will also apply to the project. The progress from Scoping Study to the Interim Business Case stage will initiate the process of ascertaining value for money of a PPP arrangement compared to public sector delivery.

5.3 Outcome

The Scoping Study will in most cases result in a government decision on whether or not to further examine the delivery options brought forward.

Stage 2

Project Options

6 Interim Business Case

6.1 Function

The Interim Business Case is developed to provide government with sufficient information about the expected value for money of the available delivery options to assist the government in making a decision on the preferred option. Users of this guide should note that if at this stage it is decided that a PPP approach is not suitable, they should revert to the normal Budget process for capital proposals.

The Interim Business Case takes the established service need and project objectives defined in the Scoping Study and conducts a closer analysis of the recommended delivery options. This will include a preliminary analysis of a Public Sector Comparator (PSC) and a project assessment for PPP suitability.

The PSC is a cost model for a traditional procurement (or other feasible delivery option) that reflects the public sector retaining ownership and responsibility for construction/ redevelopment and ongoing management of the project, even though a range of the required services for delivery may be outsourced.

The Project Assessment – PPP Suitability Checklist is designed to help with identifying whether a PPP procurement approach for a particular project may have the potential to deliver value for money to government. This Checklist takes a qualitative rather than quantitative focus and is designed so that it can be completed in-house (refer to Appendices A and B for further detail on the PSC and Project Assessment – PPP Suitability Checklist).

6.2 Framework

To provide government with sufficient information to make a decision, agencies should determine the most efficient delivery option through assessing both public and private sector ownership and management models.

The key steps of the Interim Business Case stage are:

- refinement of project scope and documentation of Project Plan;
- communication with project stakeholders;
- further development of risk analysis;
- development of the PSC and the PPP Suitability Assessment Checklist;
- assessment of market interest; and
- recommendation and submission to government.

Interim Business Case 6

6.2.1 Stakeholder Communication

A stakeholder may be an individual or a group of individuals such as government, employees, service providers, service consumers, consultants or other external parties who have an interest in the project. Each stakeholder will have a specific interest area, such as financial, technical, regulatory or personnel management. In identifying a project's stakeholders it is important to recognise their specific interest to ensure that their expectations can be managed effectively. The success of a project relies upon co-operative contributions and support from all involved. This will only be forthcoming if stakeholders have a good understanding of the project and its progress. Communication channels should therefore be established from an early stage and maintained to manage stakeholders' expectations throughout the project's life cycle.

6.2.2 Refine Project Scope

Project scope will vary on a project-by-project basis, but the common objective is to consider the needs of the agency in meeting the service demands of the community and the requirements of government. Project scope is defined through proper identification of the project objectives and agency service needs.

Project scope should:

- include the project objectives and the agency service needs;
- define the timeframe for delivery;
- outline the required range of services and the expected quality of service delivery regardless of who delivers the services; and
- be a comprehensive document focusing on what is needed, not how it is to be provided.

Project scope is initially established in the Scoping Study stage but is further refined in the Interim Business Case stage in order to properly identify costs and risks. Well-defined scope will also enable value for money to be determined with greater accuracy.

The agency may need to employ technical experts in determining the project scope that may also be involved in estimating the PSC.

For example, in the provision of an office building project, issues to consider in developing the scope may include:

- site location;
- decant arrangements;
- date of service commencement;
- project (not asset) life; and
- services to be provided by government and the private sector respectively;

6 Interim Business Case

- transitional arrangements;
- quality standards;
- upgrade or expansion requirements during the project; and
- performance measurement and payment criteria.

As the agency will not be operating the asset under a PPP approach, the scope of the project should be defined in terms of key deliverables, allowing greater design flexibility and opportunities for innovation for the private sector.

6.2.3 Document Project Plan

The Project Plan provides an outline of how and when a project's objectives are to be achieved by listing:

- the major activities and deliverables;
- timetable and key milestones; and
- resources required for the project.

The Project Plan is a key management tool and should be used by management as a baseline against which to monitor project progress and cost through each development stage. Preparation is crucial to successful delivery, and investing sufficient resources in developing a carefully designed Project Plan will help in delivering the project within budget and on time. The Project Plan should be agreed by the Steering Committee early in the process and re-considered as circumstances change.

6.2.4 Undertake Risk Analysis

Consideration of a range of possible delivery options requires greater concentration on risk analysis and management. The initial identification of the project's major risk categories from the Scoping Study will now be revisited and subjected to further analysis. This analysis will include:

- initiating the Risk Management Matrix;
- valuing major quantifiable risk categories for inclusion in the PSC;
- identifying the risk transfer/sharing between the parties; and
- reporting all identified risks in a Risk Register.

Detailed guidance on these activities is available from *Public Private Partnerships: Risk Management*.

Interim Business Case 6

6.2.5 Develop PSC

In considering a PPP procurement, it is necessary to determine what would be the most feasible and efficient delivery of the project scope by the public sector. The financial model that represents this delivery option is the PSC. It must be thoroughly researched and documented with sufficient time and resources allocated to warrant its accuracy and reliability.

The key provisions of a PSC model are that it:

- incorporates the most efficient and realistic method of public sector procurement;
- represents the whole-of-life costs of the project; and
- accounts for both project and market risks, which may deliver costs or benefits over the project's life cycle.

In general, traditional procurement is the most common model for PSC construction. Alternatively, in the case of a property development, a sale and leaseback arrangement may be a more appropriate traditional procurement option. A sale and leaseback will apply where a building initially constructed through traditional procurement is subsequently sold and leased back to the government. In such a case the PSC should be a construction, sale and leaseback arrangement as opposed to a traditional procurement.

It is important that the PSC is a fair and equitable reflection of direct public sector procurement and that it addresses the project scope, and all associated risks, at the required performance levels. It must also be structured to enable comparison to the private sector bids and robust enough to defend value for money decisions made on the basis of this comparison in the RFT stage. It must also be accurate enough to be relied upon as a cost model, should the government decide to pursue a direct rather than a PPP procurement.

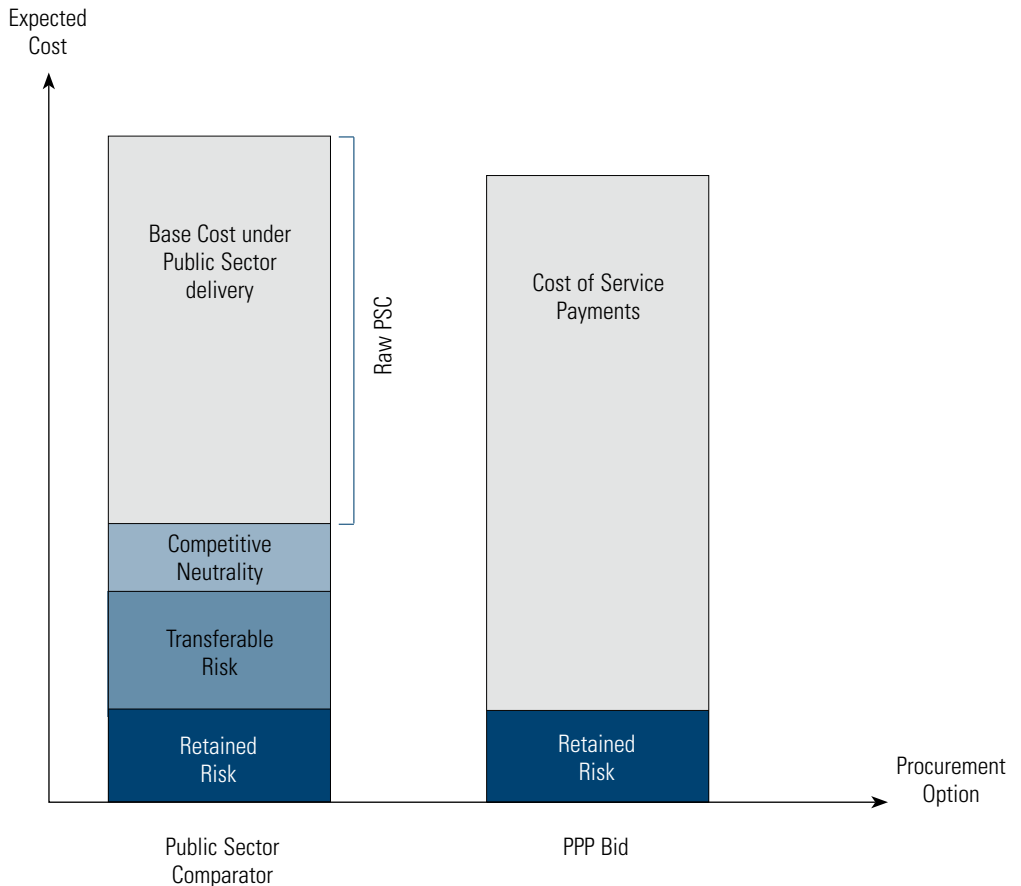
The PSC consists of three core elements, being:

- Raw Cost (referred to as 'the Raw PSC');
- Competitive Neutrality; and
- Risk (Transferable Risk and Retained Risk).

The PSC is represented as a discounted cash flow (DCF) model, resulting in a net present value (NPV) of the expected cost of public sector delivery. The relationship of the core elements of the PSC and the actual private sector bid is outlined in Figure 5.

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Figure 5: PPP Cost Models



The PSC is a quantitative tool and represents the present value of a stream of expected future cash flows associated with traditional procurement. Detailed guidance on the appropriate discount rate to be used for NPV analysis is available from the PPP Unit.

The PSC is an approximate measure of the whole-of-life project cost that is dependent upon a range of long-term value forecasts and risk impacts. It is recommended therefore that agencies present a range of likely outcomes of the raw PSC (i.e. best case/expected case/worst case) rather than a single point estimate.

Further detail on the PSC is provided in Appendix A.

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6.2.6 Develop the Qualitative Assessment

Due to the inherent uncertainty of financial estimates in the early stages of project development, a qualitative rather than a quantitative assessment of the PPP option is required within the Interim Business Case. The qualitative assessment should consider non-financial factors such as degree of confidence in good whole-of-life performance, social benefits, aesthetic design, functionality and quality of inclusions, political risks and innovation. Consideration must also be given to whether the project is suitable for the private sector ownership and management model.

Some general qualitative considerations that might be discussed in the Interim Business Case are²:

- social and economic impacts – social benefits, design functionality, environment;
- political impacts – regulatory issues, government policy, public debate;
- organisational impacts – structure, change management, human resources, cultural changes; and
- operational impacts – service delivery, synergy, sustainability and technology.

The following section outlines more specific qualitative considerations that should be discussed in the Interim Business Case.

6.2.7 PPP Suitability Assessment Checklist

A PPP option should be considered where it has potential to offer superior value for money relative to other procurement methods. As a general government policy, the lowest priced option does not necessarily represent the best value for money.

The PPP Suitability Checklist (Appendix B) is an appropriate indicator of the likelihood of achieving value for money from a PPP option at the Interim Business Case stage.

Value for money from PPP can manifest itself as one or more of the following:

- The delivery of a service or capability at a lower cost;
- Greater certainty of an expected financial outcome due to less exposure to significant risks;
- Increased benefits to the end users of a service due to the public sector's focus on service delivery rather than asset procurement; and
- The encouragement of innovation and efficiency on the part of the private sector by allowing the private sector to deliver an output without requiring detailed prescriptions on how to deliver the service.

² Qualitative value for money measures taken from Queensland Department of State Development, *Business Case Development*, 2002, p25.

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When agencies are seeking funding for new investments, or advising government of new spending funded from existing appropriations, they are required to consider a range of procurement options from direct procurement through to a PPP arrangement.

- Particular attention should be given to opportunities with potential for long-term contracts (e.g. 15 to 30 years) involving asset based procurement with a whole-of-life cost in excess of \$100 million, where there is opportunity to:
 - transfer an optimal level of ownership and operational risk, including residual value risk, to a private sector party;
 - group a range of individual service and asset provision contracts into a single long-term contractual arrangement; and
 - implement a performance based contract.
- In addition, the ability for the private sector project to earn additional revenue by selling excess capacity associated with the underlying infrastructure to third parties may also be an indicator of PPP viability.
- Such projects should be examined to see if a PPP type arrangement may offer better value for money over traditional financing and ownership options. In these instances government should be advised of the results of the consideration of the PPP option and be given a detailed explanation where the PPP option is rejected.
- Agencies considering such proposals should take into account and adhere to the PPP Principles and the PPP guidance papers, and at the earliest opportunity consult with their Agency Advice Unit and the PPP Unit within Finance.

Projects in the range of \$20 to \$100 million may also be considered as a PPP. Where there is uncertainty about the application of the PPP Principles the PPP Unit should be consulted.

Agencies can use the PPP Suitability Checklist (Appendix B) at the Interim Business Case stage to justify why a PPP option should be explored in the initial stages of project development.

- Particular reference should be made to how the main business driver for the project is likely to be compatible with, and benefit from, a PPP.
- Where the relevant characteristics in the Checklist are present, a PPP option is required to be considered with an assessment of its effectiveness as part of the Budget process.

An indication of PPP procurement suitability should be explored in the Interim Business Case through inclusion of a risk analysis. This should include identification of key risks and their allocation between public and private sectors under traditional and PPP approaches and an indication of which risks are likely to result in a value for money outcome when transferred under a PPP approach. Refer to Section 6.2.4.

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6.2.8 Assessment of Market Interest

Part of the Interim Business Case is gaining a good indication of the market's view of the project. This is achieved by:

- engaging or talking with market experts; and
- possibly conducting industry briefings to gauge interest.

Private sector engagement can often lead to an increased number of options not yet identified or variations to project scope to increase project functionality or efficiency.

It is important that project officers are mindful of probity and intellectual property issues which can arise through market involvement at this early stage.

Market assessment will involve consideration of its capability to provide a reliable service, the potential for achieving value for money, the level of rewards to industry for investing as well as the impact of government legislation and policy on industry's involvement.

6.2.9 Assessment of Public Interest

The agency's duty of care to the public and the impact of any delivery option on the public must be considered, especially on those stakeholders identified as being directly affected by the project. An initial review of stakeholders will have been undertaken during the Scoping Study. This review will undergo further development in the Interim Business Case with a focus on issues that may arise through project development and delivery. If appropriate, the agency should liaise with public interest groups and other relevant bodies and consider possible outcomes of a qualitative or quantitative nature that may possibly impact upon the value for money analysis.

The public consultation should consider the following points:

- effective achievement of service requirements;
- accountability and transparency;
- affected stakeholders;
- consumer rights;
- public access and equity;
- security; and
- privacy.

It may be appropriate for public consultation to continue throughout the life of the project (or at least during construction and the early years of operation), especially if it is deemed to have a major impact on the community. There are many avenues for communicating with the public, e.g. newsletters, email, flyers and public consultation forums.

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6.2.10 Examination of Other Constraints

Following on from the Scoping Study assessment, appropriate further consideration and analysis should be devoted to issues such as:

- Environmental impact;
- Planning approvals and processes;
- Cultural Heritage;
- Native Title; and
- Other specialist areas.

Examination of these matters for each delivery option will identify any potential impact upon the potential value for money. It is important to recognise any potential impact in the Interim Business Case, even if the results of detailed studies may not be available until the RFT stage.

6.2.11 Recommendation and Submission to Government

The aim of the Interim Business Case is to provide the government with sufficient information about the potential for value for money from the available delivery options to enable a decision on the preferred option and whether to engage the market in a tender process. A qualitative assessment based on the PPP Suitability Checklist will provide the basis for decision making of which delivery option will produce the best outcome.

At completion of the Interim Business Case stage, a recommendation must be made to government on the preferred option and whether the project should go to tender as a PPP procurement.

A submission identifying the recommended delivery option along with supporting information should then be made to government or the Minister for Finance and Administration (depending on the value of the project – refer to Section 3.2.1) for consideration.

The aim of the submission to government is to obtain:

- support for the recommended delivery option (assumed to be PPP);
- approval of the expected budget impact of the recommended delivery option;
- if necessary, approval of resources required for the market tender process; and
- approval to proceed to EOI and RFT stages. In most cases, a second submission to government will be required prior to entering into a contract.

Finalisation of the Business Case will occur once the RFT stage is completed and before negotiations with the preferred tenderer commence.

If government approval for the recommended delivery option, assumed to be PPP, is not given, then the agency management or executive will have the option to implement the project based on the delivery option contained in the PSC.

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6.3 Outcome

The Interim Business Case will have the following outcomes:

- establishment of communications with stakeholders;
- establishment of detailed project scope as documented in the Project Plan;
- risk assessment summary and risk allocation strategy;
- evidence of existence of competitive market for the project;
- documented PSC estimate;
- potential for value for money based on the qualitative assessment; and
- preferred delivery option.

7 Expressions of Interest

7.1 Function

This section on the EOI stage assumes that PPP is the recommended and preferred delivery option.

The EOI stage aims to test market interest and suitability and establish a shortlist of preferred tenderers who are capable of delivering the required service outputs and have the financial capacity to undertake the project.

The key steps are as follows:

- develop EOI request documentation;
- present proposal to Parliamentary Joint Standing Committee on Public Works;
- advertise EOI;
- evaluate EOI; and
- report to Steering Committee.

7.2 Framework

The CPGs contain a number of new requirements which must be observed when approaching the market. These requirements cover areas such as:

- the manner of publishing and distributing request documentation;
- the contents of the request documentation;
- time limits for lodging submissions; and
- procedures for receiving and evaluating submissions.

It is mandatory for agencies to conduct their approach to the market in accordance with these requirements, and agencies should engage appropriate advisers at an early stage to ensure that they are in compliance with the new guidelines.

7.2.1 Develop Expressions of Interest Documentation

The EOI request documentation serves two important purposes:

- To provide potential tenderers with sufficient information to make an informed decision as to whether they are capable of and interested in delivering the required services; and
- To ensure that the agency is capable of selecting with confidence from all submissions a preferred list of tenderers who have the capacity to achieve the service delivery criteria.

An assessment should also be obtained from the independent probity auditor on the EOI documentation prior to public release.

Expressions of Interest 7

The EOI documentation should provide clear guidance and sufficient detail on the project's service delivery requirements and the agency's evaluation processes. It should be brief and to the point, and assist potential tenderers to quickly address, at a relatively low cost of tendering, the issues on which the agency needs to have information in order to develop a shortlist.

The request documentation should provide the following:

- brief introduction to the agency, its purpose, function and background;
- project objectives and relationship to the agency's strategic aims and objectives;
- outline of the service requirements of the project, including any policy imperatives;
- scope of services to be delivered by the private sector;
- the agency's role within project service delivery;
- proposed project risk allocation model;
- the required level of information that tenderers must submit;
- any available specialist technical reports;
- known project constraints, including legal, financial, policy, budgetary, as well as environmental and heritage regulations, taking into consideration the approvals and processes required under the *Environment Protection and Biodiversity Conservation Act 1999*;
- timeframes and assessment criteria to be used in evaluation, clearly highlighting any mandatory criteria; and
- general terms and conditions of EOI management.

As mentioned above, the CPGs contain additional requirements on the contents of request documentation. These must be taken into consideration when writing and finalising the documentation.

7.2.2 Advertise Expressions of Interest

The EOI is advertised inviting all interested parties to register their interest. The advertisement and distribution of request documentation is covered in the CPGs, and the procedures contained in related guidelines must be followed in the process of informing the market.

A briefing session may also be held, giving the agency an opportunity to clarify its view of the project's scope, gain further market feedback on the project structure and deliverables and discuss any other relevant matters. To ensure probity is maintained, briefings and communications must be transparent and treat all interested parties in a fair and equitable manner.

7 Expressions of Interest

7.2.3 Evaluate Expressions of Interest

The evaluation of EOI will involve:

- establishment of an Evaluation Team to review the submitted EOI in an unbiased and systematic way and to prepare an Evaluation Report. It may be necessary to utilise external experts in specific project fields, e.g. technical, financial;
- formal agreement by all Evaluation Team members on the evaluation criteria and the methodology used to derive an overall EOI ranking;
- evaluation of all EOI responses against the criteria stated in the documentation;
- security and confidentiality of all responses;
- an independent probity auditor to ensure a fair and equitable assessment process;
- the development and issue of the Evaluation Report as agreed by all Evaluation Team members; and
- determination by the Evaluation Team of a shortlist of parties with the necessary technical and financial capabilities who will receive the Formal Bid Documents. As a guide the shortlist should contain at least three parties, in order to ensure that a satisfactory level of competitive tension is maintained.

In determining the shortlist, the Evaluation Panel should consider the following evaluation measures:

- capacity to achieve service delivery, taking into consideration all consortium members, e.g. finance providers, design and construction contractors, long-term operators and maintenance providers;
- industry performance to date;
- suitability of consortium to the project; and
- method and mode of service delivery, considering innovation and quality of service and a demonstrated understanding of the required outcomes and objectives.

Attention should also be given to the problem of related party tenderers, which may otherwise impact on the agency's objective of maintaining competitive tension.

7.2.4 Report to Steering Committee

The Evaluation Team will report its recommendations to the Steering Committee and seek endorsement to move forward to the RFT stage.

All tenderers must be advised at the same time of the EOI evaluation outcome, with those shortlisted being invited to the RFT stage. In accordance with the CPGs, those tenderers that are not shortlisted are entitled to request a written debriefing on the reasons for their non-selection.

Expressions of Interest 7

7.2.5 Parliamentary Joint Standing Committee on Public Works Submission

In the case of infrastructure projects, the Steering Committee should ensure that before giving endorsement to progress to the RFT stage, a project submission is made to the Parliamentary Joint Standing Committee on Public Works.

Also known as the Public Works Committee (PWC), the Committee is constituted by the *Public Works Committee Act 1969*. The Act requires that all public works for the Australian Government, which are estimated to cost more than \$15 million, must be referred to the Committee. There are some exceptions to this rule, but essentially all public works sponsored by Australian Government departments and major statutory authorities come within the ambit of the Committee's investigatory powers.

Background information about the functions, responsibilities and membership of the Committee, how it operates and guidelines for the preparation of submissions is available from the Committee's website www.aph.gov.au/house/committee/pwc.

Determining whether a project requires a submission to the PWC will require consideration of the particular details of each project. Agencies should contact the Special Claims and Land Policy Branch in Finance in the first instance.

Sufficient time to allow PWC consideration of the project should be built into the project timetable. Submission to the PWC needs to be carefully considered and planned in advance to ensure that the process can be completed as efficiently as possible. The submission can be made whenever sufficient information on scope and cost is available to address the key concerns of the Committee. These include, among others:

- the stated purpose of the project and its suitability for achieving that purpose;
- the need for the project; and
- the cost-effectiveness of the project.

The specific details of PPP proposals are often uncertain until after the RFT stage when the bids are received, containing tender quality information. This is later in the contractual process than is the case for typical proposals referred to PWC. For this reason, PPP proposals may need to be referred to PWC for a public hearing in parallel to, or post the EOI stage for agreement to the project.

PWC estimates that the time allowed for the entire inquiry process is a minimum of three and a half months. A lead time of at least six weeks should be allowed between referral of the project and a public hearing required by the PWC. Another two months should then be allowed between the public hearing and the tabling of PWC's report in Parliament. These time periods represent average durations experienced in the past, however, actual times may vary depending on the individual circumstances of the project.

7 Expressions of Interest

For detailed guidance refer to the PWC Manual of Procedures for Departments and Agencies.

7.3 Outcome

An EOI can be issued in parallel to PWC referral and a shortlist of tenderers selected for the RFT stage.

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8.1 Function

The purpose of the RFT stage is to release the Formal Bid Documents to shortlisted tenderers, evaluate the formal bids and recommend the preferred tenderer. The Formal Bid Documents are the Project Brief and Project Contract.

Agencies should consider at this stage the necessity of bid bonds or similar arrangements requiring tenderers to commit to the terms of their proposals. Advice on this matter should be obtained from legal or commercial advisers.

8.2 Framework

The key steps in the RFT process are:

- develop tender documentation; and
- conduct the evaluation process, resulting in the identification of a preferred tenderer.

8.2.1 Public Sector Comparator Disclosure

Industry Opinion

An agency should aim to achieve an effective and competitive bid process. In releasing PSC information during the bid process, the agency will influence the state of competition. Recent Australian experience indicates that provision of the raw PSC cost data will provide tenderers with an affordability range for the project. This reduces the risk of receiving non-conforming tenders that propose project outcomes that are not appropriate or affordable. There remains room in the bidding process for competitive pricing through retention of risk premium assumptions as value for money will be generated where industry can manage these risks more cost-effectively than government. Release of the PSC information may also encourage competition on a quality basis rather than on price alone.

The disclosed PSC information should only include the PSC's raw cost and competitive neutrality factor. It should not include the value of Transferable and Retained Risks. It is important to recognise that releasing the PSC in the public domain means that it will come under public scrutiny. The agency must therefore have a high level of confidence in its calculations and assumptions before allowing the release of the data.

Timing of Disclosure

The recommended disclosure point of the PSC information is at issue of the Project Brief.

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Refining the PSC

After finalising the PSC and issuing the relevant information to tenderers, there is limited opportunity to refine the PSC. This would generally only occur if material error was identified or there was a change in project scope. Essentially, this means that the PSC released at this stage will ultimately be the model used to assess the value for money of the PPP bids.

In general, caution needs to be exercised in amending the request documentation after release. If it is unavoidable, it should always be done in consultation with the probity adviser.

8.2.2 Development of the Project Brief

The Project Brief is a key document within any PPP project. It is one of the Formal Bid Documents released by the agency to shortlisted parties and constitutes the basis for their bids. It is important to invest sufficient time and resources in its development to ensure that it is a true and fair representation of the project's scope.

Key components of the Project Brief are often those developed during prior stages of the project and include:

- background information on the project's origin, including social, economic and financial drivers;
- defined scope and objective of the project and the agency's role in service delivery;
- output specifications, key performance indicators and the associated payment mechanism;
- risk allocation strategy;
- conclusions of project specific specialist reports, e.g. environmental, community service obligations;
- legal, regulatory, policy or commercial constraints, e.g. transitional requirements;
- evaluation criteria (includes reference to PSC), timeframes and deliverables;
- key arrangements relating to the Formal Bid Documents, including rules and regulations covering bid lodgement, presentation, communication, negotiation, reservation of rights, confidentiality and security;
- agency's position on changes to the Project Brief and treatment of non-conforming bids; and
- other specific information requirements for the RFT process.

The economic structure, performance measures, proposed payment mechanism and any other commercial principles relating to the project should also be provided for in the Project Brief. It is important that:

- performance monitoring requirements stipulated by the agency be stated and agreed by all tenderers during this phase of procurement;

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- any monitoring undertaken by the contractor be subject to periodic independent verification; and
- the key principles, features, objectives and any particular issues relating to the payment mechanism be assessed and documented at this stage to ensure it is realistic and provides adequate incentive to tenderers.

The independent probity auditor should issue a sign-off in writing on the Project Brief.

Supporting data should reflect relevant and material information compiled during the project development process. It will vary depending on the project and shortlisted tenderers may be given access through a data room or other facility. It may also be necessary and beneficial to organise briefings, presentations or other general communication meetings with shortlisted tenderers.

8.2.3 Project Contract

The Project Contract is the legally binding document for the project and is a companion document to the Project Brief. The agency and its legal advisers are responsible for drafting the Project Contract and shortlisted tenderers will be provided with a draft as part of the Formal Bid Documents. Input from other advisers may also be required, for example from the financial advisers with respect to risk allocation issues.

Shortlisted tenderers have the opportunity to comment, with any re-drafting to be at the agency's discretion.

Changes during the project's life cycle are highly likely given the time span involved, and the Project Contract must be sufficiently flexible to accommodate such change without causing disadvantage to either or all parties.

Key contractual issues that are common to most Australian Government PPP projects will be:

- tenure and access;
- contract flexibility;
- services and service commencement;
- performance monitoring;
- payment regime;
- intervening events and force majeure;
- insurance;
- agency step-in rights and safeguards;
- default and remedies;
- termination;
- dispute resolution; and
- employee rights.

These are discussed in greater detail in *Public Private Partnerships: Contract Management*.

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8.2.4 Formal Bid Evaluation

Formal bid evaluation will involve:

- drafting a Tender Evaluation Plan and endorsement by the senior decision-maker prior to release of the request documentation;
- evaluation of all responses to the Formal Bid Documents against the criteria stated in the Project Brief. It may be necessary to utilise external experts due to the complexity of the service delivery requirements, e.g. facility management, commercial structure;
- formal agreement by all Evaluation Team members on the evaluation criteria and the methodology used to derive a final ranking outcome;
- security and confidentiality of all responses; and
- involvement of an independent probity adviser to ensure a fair and equitable assessment process.

The Evaluation Team's aim is to determine which bid and delivery option will deliver the best value for money. To do this the Evaluation Team should consider the following:

- financial comparison of the formal bid to the PSC. This will form part of the value for money comparison to ensure that the benefits of procuring the project using a PPP approach remain superior to those associated with the alternative public sector delivery option modelled in the PSC;
- compliance with mandatory Project Brief submission requirements and achievement of project scope; and
- response to the risk allocation model and other commercial considerations.

The Evaluation Team should then prepare an Evaluation Report that summarises the formal bids received and the outcome of the assessment against the PSC and other evaluation criteria. There should be a recommendation for either a preferred tenderer or that the project should follow a traditional procurement delivery option if the formal bids fail to demonstrate value for money under a PPP arrangement.

8.2.5 Efficient Bidding Process

High bid costs can act as a major deterrent to wider industry participation in PPP procurement. This can result in a reduced level of competition in the tender process, leading in the long run to reduced value for money for government. It is therefore in the government's best interest to keep bid costs to a minimum. This can be achieved in a number of ways, including:

- giving industry a good understanding of what government wants through clearly defined output requirements. These need to be carefully communicated through the Project Brief and other means where appropriate. This is to minimise the risk of tenderers wasting time and money on bids that do not meet government's needs;

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- disclosure of the raw PSC (for more detail see Appendix A); and
- conducting interactive RFT processes for projects with critical design requirements. The main purpose is to ensure that tenderers are fully aware of government's requirements and do not waste time and money on non-conforming designs. These processes need to be carefully planned and prepared, in particular to avoid breaching the non-discrimination requirements of the CPGs. It is recommended to seek advice from the PPP Unit and a probity adviser before conducting such processes.

Implementing measures such as those listed above will maximise the chances of an efficient evaluation process leading to the selection of a single preferred tenderer. In some cases this may, not be possible due to inseparability of bids or a large number of outstanding issues requiring settlement. A second-round Best-And-Final-Offer (BAFO) process may therefore be required to finalise the government's preferred choice. It should be borne in mind that such processes represent additional bid costs to industry, and may lead to a reduction in private sector participation in future tenders if applied in cases where they do not add value.

8.3 Outcome

The RFT stage outcome is the identification of a preferred tenderer and procurement approach. As mentioned above, BAFO processes may in some cases be necessary, but should always be carefully considered in view of the additional bidding costs imposed on industry.

9 Final Business Case

9.1 Function

The Final Business Case should:

- report on the conclusions of the RFT stage and set out the final scope and cost of the project;
- be a supporting document to a government submission once a preferred tenderer has been selected;
- include a qualitative assessment of the preferred tenderer and a final PSC comparison against the preferred bid to confirm that best value for money is achievable; and
- provide government with an indication of the agency's forward plan for proceeding with the project and finalising a contract with the preferred tenderer.

9.2 Framework

The key steps in the Final Business Case stage are:

- Update the Business Case using the actual tender data received in the RFT process;
- Determination of the likely accounting classification and expected budget impact;
- Value for money assessment; and
- Finalise a submission to government seeking approval for the preferred tenderer and recommended procurement approach.

9.2.1 Update Business Case

The outcome of the market tender process is a more accurate understanding of the project's scope and risk-adjusted cost. Value for money can now be reliably determined by comparing the actual PPP bids received with the PSC and evaluating the qualitative advantages of the bids compared to a traditional procurement. The Interim Business Case can therefore be updated to reflect the conclusions of the formal bid Evaluation Report.

As a general rule, the PSC should not be changed after the RFT has been released. Circumstances may, arise where it makes sense to do so. An example is an unexpected and drastic change in market conditions, for example a rapid increase in construction or insurance costs, which invalidates the assumptions made in constructing the PSC. Any changes must be discussed with the probity adviser and require approval by the Project Director or the Steering Committee in case of significant changes. Care must be taken to ensure that any changes made do not unfairly advantage a particular tenderer or a particular group of tenderers, as set out in the CPGs.

The independent probity auditor should also submit a final report on the bidding and evaluation stages, to provide assurance that a fair and equitable process has been followed.

9.2.2 Value for Money Assessment

Achieving value for money is a fundamental outcome for an Australian Government project. It is the measure that is paramount in securing government approval to take the project to tender and contract close.

The aim of the Final Business Case is to provide government with sufficient information about the value for money through the preferred procurement option to enable a decision on whether to engage the market in a tender process. The decision should be based on both a quantitative and qualitative assessment.

Quantitative Assessment

The quantitative assessment at the Final Business Case stage is based on a DCF analysis comparing the PSC with private sector bids, and is validated by undertaking sensitivity analysis.

Future cash flows are inherently uncertain. It is therefore useful to consider a variety of outcomes determined through sensitivity analysis of key variables. The DCF analysis will result in a range of net present cost values for the value for money comparison of the PSC and private sector bids (i.e. best case/expected case/worst case) within which the final outcome may be assumed to lie.

Examples of common variables used for sensitivity analysis are:

- capital cost;
- inflation;
- discount rates;
- operating, maintenance and other cost categories; and
- third party revenue.

Further detail on the quantitative value for money assessment is provided in Appendix C.

9.2.3 Determine Accounting Classification

The accounting classification of a PPP arrangement is generally determined by the Australian Accounting Standard “Leases” (AASB 117), which mainly reflects the allocation of ownership risks inherent in the transaction.

Consideration needs to be given to whether the PPP arrangement will be classified as an operating lease or a finance lease under AASB 117 as they have different budget impacts (see Section 9.2.5). However, the assessment of value for money is not affected by the budget impact of alternative procurement methods. The assessment should also be independent of the eventual accounting classification of a PPP arrangement.

9 Final Business Case

The key test in determining which type of lease exists is whether the lessor or the lessee enjoys the majority of the benefits and bears the majority of the risks incident to ownership of the asset concerned (this is known as the “substance test”). Examples of such risks are those related to unsatisfactory performance, obsolescence, losses/gains in realisable value and others. If the lessor has the majority of the benefits and risks, then an operating lease classification is appropriate. If the majority of the benefits and risks are borne by the lessee, then a finance lease exists.

9.2.4 Determine Expected Budget Impact

The following information is offered to assist the reader in gaining a general understanding of budget issues in a PPP project. All matters related to budget impact must be discussed with Budget Group within Finance at an early stage. A correct assessment and understanding of such impact is vital to ensure the government is fully informed.

Accounting classification of a PPP project determines the budget impact of the project. This is particularly relevant because of adoption by the Australian Government of the Government Finance Statistics (GFS) reporting framework, which provides for a different ‘bottom line’ impact for finance leases compared to Australian Accounting Standards.

Under traditional procurement, the budget will be impacted at the time the asset is acquired and as through life costs are incurred. If the government issues debt to fund the asset purchase then the related interest expenses impact on the budget in the years that interest is paid.

Treatment of a PPP arrangement will depend upon the classification of the arrangement as an operating or finance lease. In accordance with GFS, for an operating lease the value of the asset is not recorded on the government’s balance sheet. The lease payments impact on the budget (underlying cash and fiscal balance) when they are paid.

For a finance lease, the capital value of the asset is recorded against the budget when the risk/benefits of ownership pass to the government. As lease payments are made over the project’s life cycle, they are split into capital and interest components. Only the interest component impacts on the budget to ensure no double counting.

As with other procurements, the government needs to be aware of the budget impact of PPP arrangements at an early stage for consideration in the preparation and management of the budget. Agencies should be aware that the commitment of future expenditure might also require authorisation under Regulation 10 of the FMA Regulations before the spending proposal can be approved.

9.2.5 Determine the Impact of Tax and Other Payments to Government

The taxation impact associated with the project’s structure and the application of current infrastructure related tax provisions, such as Section 51AD and Division 16D of the *Income Tax Assessment Act 1936*, and any other tax legislation must be determined.

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At the time of preparing this guide, draft legislation to replace Section 51AD and Division 16D was being prepared by the Department of the Treasury. Agencies should seek advice on the implications of any new relevant legislation that may affect the taxation treatment of the project.

Other government payments, which may include land tax, stamp duty, payroll tax or other charges should be included in the value for money consideration at the Final Business Case stage.

9.2.6 Value for Money Measures

Demonstrating value for money confers confidence that the whole-of-life costs and risks of the project have been assessed. In basic quantitative terms, value for money for a PPP project is delivered if the risk-adjusted cost of delivering the project scope under the preferred PPP bid is lower than that achieved through direct public sector procurement (i.e. PSC).

Additional assessment criteria, such as qualitative measures (e.g. service delivery, technology, regulatory issues, change management) and other constraints are also important factors in the value for money outcome. The guide provided in Section 6.2.6 is a useful starting point for the qualitative assessment.

9.2.7 Submission to Government

This Final Business Case should form part of the final submission to government. The submission should identify the preferred tenderer, the expected terms of the contract, and recommend a specific approach to project delivery. The submission should clearly outline the funding requirements for the proposal including the budget impact, accounting classification and any taxation implications. It should be noted that an agency is not allowed to terminate a procurement unless it can demonstrate that it is not in the public interest to proceed.

It is in any case strongly recommended that the agency should have clarified at an early stage what approvals are required and at what stage they should be applied for. In addition to consulting the PPP Unit on this matter, this issue must also be discussed with the Finance's Budget Group at an early stage to prevent unexpected issues and delays from affecting the project timetable.

9.3 Outcome

The Final Business Case outcome is a submission to government to seek approval of the preferred tenderer and the expected terms of the contract.

10 Negotiate with Preferred Tenderer

10.1 Function

Once government approval is given for the preferred tenderer, then negotiations should commence immediately to finalise the Project Contract and complete all necessary disclosure duties.

10.2 Issues for Consideration

- Negotiations can in exceptional cases be conducted simultaneously with more than one preferred tenderer if, for example, there are two very similar bids, in which case the agency may conduct parallel negotiations to secure the best possible terms for government. The possibility of the agency adopting such an approach and the conditions under which it may decide to do so should be set out in the request documentation. It is recommended to declare an official result before starting negotiations and inform unsuccessful tenderers of the agency's decision.
- The negotiating team should be kept as small as possible in the interest of conducting an efficient negotiating process. The agency's position on the negotiating issues should be defined and agreed prior to negotiations starting.
- Negotiating issues should be limited to the variations from the proposed Project Contract outlined in the formal bid responses. The agency may reserve the right to open negotiations with other tenderers if the preferred tenderer seeks to change its written proposal or the risk allocation. Appropriate clauses to this effect should be included in the request documentation.
- Careful preparation should ensure that financial close occurs as soon as possible after contract execution. This normally entails the provision of government approvals such as tax rulings that are dependent on signed contracts being submitted.
- Debriefs must be offered to unsuccessful tenderers. Government obligations for disclosure of signed agreements must also be observed.

10.3 Outcome

The outcome of this stage will be the signed Project Contracts and a public announcement of contract finalisation.

Stage 3

Project Delivery

11 Contract Delivery

11.1 Function

Achieving the project's objectives and Project Scope is dependent upon both the government and private parties executing their respective duties under the Project Contract. This section provides a summary of the key points raised in *Public Private Partnerships: Contract Management*.

11.2 Framework

11.2.1 Contract Management

Successful contract management requires:

- a formal contract management structure, which has been endorsed prior to agreement on all Project Contracts;
- a Project Director to lead contract management and be responsible for monitoring the project's progress on behalf of the agency;
- personnel involved and nominated during the procurement stages to assist in process continuity, in order to maintain a good understanding of the roles and responsibilities of all project parties. Personnel require strong procurement skills and specific expertise and there may be a need for the use of specialist advisers; and
- securing, sharing and utilising quality advice from the public sector and an effective communication plan.

11.2.2 Project Contract

The Project Contract presides over the relationship between the contractor and the government from contract finalisation through to contract expiry. To be effective the performance monitoring process, risk allocation strategy and payment regime must work towards achieving the government's objectives.

11.2.3 Stakeholders to a PPP Contract

It is important to understand the relationship between all stakeholders to a PPP contract. Stakeholders will have their own stated goals and methods of delivery.

Common stakeholders to a PPP project include:

- government department/agency;
- contractor – may operate as a Special Purpose Vehicle (SPV);
- PPP funds providers – debt and equity financiers; and
- sub-contractors – design, construction and commissioning, operational and maintenance.

Contract Delivery 11

11.2.4 Contract Performance

The Project Contract will define service delivery to set timeframes and under agreed conditions. The project's performance indicators require regular review so that any decline or improvement in service delivery can be monitored and corrective action taken if necessary. This should ensure adherence to the risk allocation strategy. Alterations to delivery, monitoring, payment or quality standards must be formalised under the Project Contract.

11.2.5 Contract Change Management

Implementation and ongoing management of the Project Contract requires a continued review of the project and accounting for change. The Project Contract, however, also needs to be sufficiently flexible to enable changes given the long-term nature of the contract and the inability to forecast all potential future events at the point of drafting and negotiating the contract. Changes to key elements of the Project Contract, such as payment or performance mechanisms, need a formal agency review to determine the impact on value for money.

The risk allocation strategy identifies the obligations of all project parties and the Project Contract should ensure that these obligations are delivered. If this does not occur then the integrity of the Project Contract may be compromised with a corresponding impact on achieving value for money. Mitigating actions available to the agency should be provided for in the Project Contract so as to minimise such consequences and prevent possible failure to achieve project scope.

11.3 Outcome

The Contract Delivery stage will be managed by a dedicated agency management team to ensure provision by all parties of service delivery according to the Project Contract. Further detailed guidance is available from *Public Private Partnerships: Contract Management*.

Appendices



A Contents of a Public Sector Comparator (PSC)

The key aim of a PPP project is achieving value for money. A major component in determining value for money is a quantitative comparison between the discounted cash flows (DCF) of a PPP procurement and the most efficient public sector delivery method likely to be achieved.

The PSC is a financial model of the public sector delivery method. It is a quantitative measurement tool and utilises DCF to present a model of future cash flows discounted to a present day value. The PSC consists of three core elements:

- Raw Cost (referred to as 'the raw PSC');
- Competitive Neutrality adjustments; and
- Risk (Transferable and Retained).

Before presenting more detail on each PSC element it is beneficial to introduce the DCF methodology and explain its application.

The Discounted Cash Flow Model

A DCF model will have two essential components:

- a forecast of future cash flows over a number of years; and
- an appropriate discount rate to discount back these future cash flows to their present value or cost.

The basic formula to calculate the present value of a stream of future cash flows using DCF is:

$$PV = \sum_{t=0}^n \left(\frac{CF_t}{(1+r)^t} \right)$$

Where:

PV = present value of the cash flow;

CF_t = cash flow in year t ;

r = discount rate; and

n = the number of years the cash flow is to be discounted.

Future Cash Flows

Accurate forecasting of PSC future cash flows is the single most important part of the DCF valuation. Most of the problems that occur with DCF are related to errors in the cash flows. It is also the most critical part of a DCF valuation as small errors in any of the assumptions that underpin the cash flows can lead to major errors in the DCF value calculated. Techniques such as sensitivity analysis will indicate the impact of variations in future cash flows on the present value.

Nominal Versus Real Cash Flows

The standard and recommended approach to valuation is to use nominal dollars. In other words, inflation is built into projections of future cash flows. The alternative is to use real dollars. For consistency, using nominal dollars requires application of a nominal discount rate.

Discount Rate

The discount rate used to calculate a net present value in the value for money assessment is calculated using the methodology described in the relevant guidance issued by the PPP Unit in Finance. The methodology may be obtained by contacting the PPP Unit directly. While the discount rate may change over the lifetime of the project, the rate selected at the beginning of the process should be applied consistently throughout the Business Case Development stage. The NPV results should then be subject to sensitivity testing, to ensure movements in the rate do not alter the recommended procurement approach.

During the tender assessment stage, the discount rate should be specified to tenderers and applied to each bid to enable a fair and equitable comparison between bid prices and the PSC. Again, depending on the volatility in the rate at the time, sensitivity testing should be carried out, particularly against movements in the rate that have occurred since the selection of the original rate. Further advice on this issue should be sought from the PPP Unit.

The PSC Cash Flow Model

Even though cash flow forecasts are unlikely to be accurate predictions of future amounts they should still be tested for reasonableness, taking into consideration:

- consistency with agency strategy and business need;
- relationship with similar projects; and
- awareness of current market conditions, including economic cycles, competitive environment and technological improvements.

Common Cash Flow Errors

Common errors of PSC cash flow forecasts are:

- over-optimistic assumptions for key variables, e.g. cost and time;
- inadequate consideration of short-term and long-term price variances;
- not fully accounting for potential variation over time of key components, e.g. capital expenditure and repairs and maintenance; and
- failure to recognise the inter-relationship between variables, e.g. exchange rate impact on cost of raw materials.

A Contents of a PSC

PSC Cash Flow Assumptions

A key factor in determining the PSC cash flow values will be the assumptions made, which should be documented. This provides users with greater confidence in the cash flow forecasts and greater transparency of the changes required to the model if assumptions change.

Raw Cost

The raw cost under the PSC represents the capital and operating costs to government of owning the infrastructure project or delivering the service. It covers capital acquisition, design, ongoing maintenance and service delivery over the period of the project.

The PSC raw cost, focussing on cash flows and not accruals, is comprised of two major value measures being:

- direct costs – can be assigned to a particular function or activity. For example, labour or materials used to deliver the service; and
- indirect costs – contribute to the service delivery but cannot be assigned to any specific activity (e.g. electricity charges).

Although generally not a factor in the raw PSC, third party revenue arises when market demand exists outside the agency for the asset or service and there is excess capacity to service this demand.

Depreciation expense of PSC capital expenditure is an accrual measure (i.e. is not a cash flow) and should not be included in the PSC cash flow forecasts. The whole-of-life cost of the direct procurement option must be included in the PSC cash flows. For example, the tender costs of recurring short-term facilities service contracts must be estimated and included in the PSC cash flows. However, costs incurred initially in tendering and developing the contract are sunk costs regardless of the procurement method and are not included in the PSC cash flows.

The identification of and adjustments for project risks should not be included in the PSC raw cost calculation. Consideration of these will be within the Retained Risk and Transferable Risk sections of the PSC cash flow model.

Direct Costs

These are costs that can be assigned to a particular function or activity and may vary depending upon the preferred delivery method. Common project direct costs include:

- direct capital costs – specific to service production, e.g. raw materials, plant and equipment, land and project construction costs, design costs;
- direct maintenance costs – clearly linked to servicing the project and/or

Contents of a PSC A

infrastructure asset, rather than improving or adding to it, e.g. tools and equipment, labour costs; and

- direct operating costs – relating to costs for everyday functions of the project, e.g. employee expenses, payroll tax, insurance, energy and waste management costs.

Direct operating costs can be broken down further into fixed and/or variable operating costs. Fixed costs are not dependent upon service volume, while variable costs are. Recognising such categories improves awareness and effective use of sensitivity testing of the PSC.

Revenue derived from the future sale of project assets at the end of the PSC's life cycle should be deducted from the raw cost value at the respective point in time. Such revenue should only be included in the PSC if it can be reliably measured and if it is also available in the Project Brief to tenderers assembling a PPP bid.

Indirect Costs

These are other costs that contribute to service delivery but cannot be assigned to any specific activity, and may include:

- construction overheads, e.g. site security;
 - operating overheads, e.g. postage costs;
 - corporate overheads, e.g. project teams;
 - indirect capital, e.g. equipment and capital improvements; and
 - whole-of-government adjustments, e.g. land tax, stamp duty and council rates.
- These adjustments for costs borne by the private sector and not the public sector do not fall within Competitive Neutrality (CN) policy but should be considered from an economic efficiency and whole-of-government perspective.

Determining the PSC Residual Value

Generally speaking the sale value of an asset is calculated as the total of the future cash flows it creates, discounted back to the time of sale. If the assets included in the PSC have a useful life longer than the term of the project and there is a competitive market for the asset, a residual value should be calculated in line with this approach and included in the PSC cash flows.

No generic residual value formula exists. For assets that are expected to generate constant cash flows for the remainder of their useful life, the net present value formula can be used to assess the residual value.

Calculating the Net Present Value (NPV)/Cost (NPC)

Calculation of the net present value (for inflow projects) or cost (for outflow projects) is a straightforward matter. A simplified example of an NPC to Year 5 is found in Table 1, using a discount rate of 6%.

A Contents of a PSC

Table 1: 5 Year NPC Calculation

	Year 0 \$'000	Year 1 \$'000	Year 2 \$'000	Year 3 \$'000	Year 4 \$'000	Year 5 \$'000
Net Cash Flow	-50	-20	-30	-60	-75	-55
Discount Factor	1.0000	0.9434	0.8900	0.8396	0.7921	0.7473
Present Cost	-50	-19	-27	-50	-59	-41
Net Present Cost	-246					

Competitive Neutrality

The PPP Principles require agencies that are considering PPP arrangements to comply with the Commonwealth Competitive Neutrality – Policy Statement (1996). The Commonwealth Competitive Neutrality (CN) Guidelines for Managers is available to assist agencies in putting CN into practice. In terms of a PPP, CN may be an issue if an agency earns third-party revenues from surplus capacity in the asset procured. CN policy may require an agency to make a CN adjustment for any advantage that can solely be attributed to its government ownership with potential implications for both revenue and costs. Consideration of CN applies to all 'significant' Australian Government business activities, with the significance threshold generally a commercial turnover exceeding \$10 million per annum. However, some types of business activity, such as those conducted by GBE's, are always considered significant regardless of turnover. If CN policy applies but the \$10 million threshold is not met, the PSC will still need to comply, in which case financial modelling may need to be adjusted accordingly.

The most common impact on PPP projects of Commonwealth CN policy will be in respect of taxes. CN adjustments should be recorded during the relevant period that they relate to and not in subsequent financial years.

For further guidance on the application of CN, the Commonwealth Competitive Neutrality Guidelines for Managers and other CN information are available through the Department of the Treasury website at www.treasury.gov.au.

Transferable and Retained Risk

Valuation of Risk

Project risks have a financial impact upon determining value for money. Identifying, managing and valuing risk is a fundamental step to understanding:

- potential cost of delivery to government of a PPP project;
- project risks and their impact; and
- framework of the PSC and its use in bid evaluation.

Contents of a PSC A

Identification and valuation of risks is the first step in the process. Detailed guidance is available in *Public Private Partnerships: Risk Management*. Once all quantifiable and material risks are valued they can be divided between Transferable Risks (allocated to contractor) or Retained Risks (remain with agency). All identified risks (Retained and Transferable) should be included in the PSC. The amount of work expended in defining and valuing these risks should be proportional to their impact on the PSC.

Risks exist within every project. For the purposes of the PSC, all quantifiable and material risks should be accounted for in the cash flows. In order to value project risks for the specific purpose of PSC inclusion, the following steps are necessary:

- identify risks;
- measure the outcome of each risk;
- estimate risk probability; and
- calculate expected risk value.

Further guidance on how to calculate the expected risk value is in Appendix B of *Public Private Partnerships: Risk Management*.

Transferable Risks

Transferable risks are those risks likely to be transferred to the tenderer under a PPP project. It is however a useful exercise to identify in the PSC model what component of risks could be transferred if a PPP approach is applied. Individual identification of each risk (retained and transferable) assists sensitivity analysis of the PSC model. In achieving value for money in a PPP project, optimal rather than maximum risk transfer between the private and public sectors is a vital factor. The aim is to allocate risks to the party who is best able to manage and control the risk. If the private sector is allocated a risk which is beyond its control or influence it will charge a higher premium for accepting the risk, which reduces value for money.

Optimal allocation of risks will determine those deemed to be Transferable. In achieving optimal risk allocation the following should be considered:

- parties to the project and their ability to mitigate and manage project risks. Includes consideration of past performance in risk management;
- project structure and mode of delivery;
- barriers or constraints to service delivery; and
- market response and public opinion.

The payment and pricing structure can be a useful management tool when allocating risk.

Once a project's transferable risks are identified and allocated, a value must be determined. This will incorporate the timing and therefore identification of each risk's potential cash flow impact, and result in an overall net present cost for transferable risks.

A Contents of a PSC

Retained Risks

Retained risks are those that the agency will assume under a PPP project.

Valuing retained risk is the final step in developing the PSC model. Retained Risks will vary from project to project, but common categories include:

- Australian Government legislation and regulatory risk;
- Project scope variance risk; and
- Demand risk (though this should be shared to the extent possible).

Once all material project risks have been identified, valued and allocated it is possible to sum the value of all retained risks. This will incorporate the timing and identification of each risk's potential cash flow impact and result in an overall net present cost for retained risks. Individual identification will benefit sensitivity testing of the PSC model.

As part of the bid evaluation process the value of retained risks is added to the private sector bid models to provide government with a comparable and true cost of the PPP project.

Project Assessment – Public Private Partnerships (PPP) Suitability Checklist

This Project Assessment – PPP Suitability Checklist should be used in assessing whether a PPP option should be explored in the initial stages of project development.

- The Assessment column should be used to explain the reasoning for the likelihood rating given against each characteristic.
- The Likelihood column should be ticked high, medium or low depending on the project profile against each characteristic.
- Where a project is identified in the medium to high range of likelihood rating for a majority of the checklist characteristics (if high/medium > 10/19 characteristics), it is possible that the project will be able to achieve value for money under a PPP arrangement, and a PPP option should be considered and assessed as part of the Project Business Case.
- Submissions to government should include at a minimum the assessment summary of PPP suitability.

Project Assessment – PPP Suitability					
Project Characteristic		Assessment	LIKELIHOOD		
			High	Medium	Low
Duration	Is the duration of the project likely to exceed 15 years?	<p><i>PPP arrangements are long-term in nature, typically extending over a 15 to 30 year period. The duration of an arrangement reflects the period over which the public sector is required to provide a particular service or capability.</i></p> <ul style="list-style-type: none"> • <i>Duration should be estimated from the time of financial close in tendering to the end of the project life.</i> • <i>A PPP option will need to be explored under the PPP Budget rule for property proposals including those that encompass a design, build and lease arrangement (e.g. pre-commitment leases) that are longer than 15 years in duration.</i> 			
	Is the duration of the project likely to exceed 25 years?	<p><i>As above, generally, the longer the project duration the greater the likelihood of success of PPP arrangements.</i></p>			

B PPP Suitability Checklist

Project Assessment – PPP Suitability					
Project Characteristic		Assessment	LIKELIHOOD		
			High	Medium	Low
Size	Is the cost of the project likely to exceed \$20 million in total?	<p><i>Experience suggests that larger projects – in monetary terms – have broader scope and are likely to be more suitable for PPP.</i></p> <ul style="list-style-type: none"> <i>Larger projects have greater potential to generate the efficiency gains necessary to offset the fixed costs incurred by the public and private sectors during the development and tendering stages.</i> <i>Smaller projects tend to have narrower scope and may be less suitable. Projects with whole-of-life costs greater than \$100 million are more likely to be suitable as PPP.</i> <p><i>Costs should be estimated as whole-of-life costs to government for project development and implementation on the basis of a direct procurement option.</i></p>			
	Is the cost of the project likely to exceed \$100 million in total?	As above, generally, the higher the whole-of-life project cost the greater the likelihood of success of PPP arrangements.			

PPP Suitability Checklist B

Project Assessment – PPP Suitability					
Project Characteristic		Assessment	LIKELIHOOD		
			High	Medium	Low
Risk	Is there potential to achieve value for money through the transfer of the costs of certain project risks to a private sector party? Including (but not limited to) any of the following risks:	<p><i>Risks are inherent in all projects and have the potential to significantly alter the public sector's financial outcomes. Inadequate recognition and mismanagement of risks is often the reason that some major projects run over budget and/ or over schedule. PPP provide an opportunity to allocate risks to those entities with the skills and experience to manage them at a lower cost, even where the government retains step-in rights and remains ultimately accountable to the taxpayer. Placing risk where it can be best managed will reduce the likelihood and severity of project shocks. This will also lead to lower risk premiums and therefore lowers overall project costs.</i></p> <ul style="list-style-type: none"> • For further discussion on PPP risk transfer see Financial Management Guidance 18 "Public Private Partnerships: Risk Management" • Risk transfer is the allocation of a risk onto the party who can effectively manage the risk at a lower cost. 			
	• Design and/or construction risk	<i>E.g. design modification may be required, there may be an unforeseen increase in materials and labour costs.</i>			
	• Ownership risk	<i>E.g. life of building and plant is shorter than expected.</i>			
	• Operational risk	<i>E.g. operating costs vary from original budgeted projections.</i>			
	• Residual value risk	<i>Residual value risk is the risk borne by the party that takes ownership of the asset at the end of the contract.</i>			

B PPP Suitability Checklist

Project Assessment – PPP Suitability					
Project Characteristic		Assessment	LIKELIHOOD		
			High	Medium	Low
Bundling of Contracts	Will the project involve a number of individual service contracts?	<p><i>In many cases, the provision of a service or capability by the public sector is dependent on a number of separate contracts with different contractors. PPP provide an opportunity to bundle a package of related services and an asset into a single long-term contract. The combination of a range of contracts involved in the delivery of government services not only simplifies government's contract management task, but in addition provides incentives to the private sector to design the underlying asset to minimise operating and maintenance costs.</i></p> <ul style="list-style-type: none"> <i>E.g. cleaning, maintenance, support, training.</i> 			
	Will the project involve an asset provision contract?	<p><i>PPP involve the procurement of an asset. The type of asset procured may vary greatly, e.g. office accommodation, roadworks.</i></p>			
	Is there potential to bundle a number of these contracts into a single long-term contract?	<p><i>For further discussion on PPP contract management see Financial Management Guidance 19 – “Public Private Partnerships: Contract Management”</i></p>			

PPP Suitability Checklist B

Project Assessment – PPP Suitability					
Project Characteristic		Assessment	LIKELIHOOD		
			High	Medium	Low
Third Party Revenue	Is there potential for the asset to earn additional revenue, by selling excess capacity associated with the underlying infrastructure to third parties?	<p><i>In some cases, only part of an asset's capacity is utilised by the public sector during the delivery of the service or capability. PPP provide an opportunity for the private sector to utilise the full capacity of the assets, by selling the excess capacity to the public sector and other parties. Utilising the full capacity of assets in this way effectively lowers the cost to the Australian Government of the provision of a service or capability (ie the additional revenue earned by the private sector).</i></p> <ul style="list-style-type: none"> <i>E.g. commercial/retail rentals in adjoining space, sale of excess production output to third party users.</i> 			
Performance Based Contract	Is it likely that Key Performance Indicators could be determined for service delivery?	<p><i>PPP implement the principle of 'payment for performance' by placing the private sector's remuneration at risk, contingent on their ability to meet the public sector's requirement. When putting in place a performance based contract the possible loss of revenue should be a major incentive for the private sector to maintain the service level and to rectify any shortcomings in service delivery.</i></p> <ul style="list-style-type: none"> <i>E.g. specification of performance outcomes in terms of time and quality.</i> 			

B PPP Suitability Checklist

Project Assessment – PPP Suitability					
Project Characteristic		Assessment	LIKELIHOOD		
			High	Medium	Low
Innovation	Does the project lend itself to clearly definable and measurable output specifications?	<p><i>PPP tender offers need to communicate government's output specification requirements without being overly prescriptive (e.g. number of hospital bed hours available) in order to allow private sector innovation in the choice of inputs, how services will be delivered and how the asset will be maintained. Output specifications should include the following:</i></p> <ul style="list-style-type: none"> <i>the level of service quality and design and should be related to the objective for service and user requirements; and</i> <i>any need for improvements in service standards over the life time of the contract.</i> 			
	Is the project likely to involve a high degree of complexity?	<i>E.g. there may be numerous phases and milestones involved in the project that are contingent on each other.</i>			
	Is there significant scope for innovation (including the use of new technologies) in the delivery of this project?	<i>E.g. innovative design solutions which might involve the application of intellectual property, substantial research and/or testing prior to development of the asset.</i>			

PPP Suitability Checklist B

Project Assessment – PPP Suitability					
Project Characteristic		Assessment	LIKELIHOOD		
			High	Medium	Low
Market Appetite	Is there likely to be private sector demand for involvement in this project?	<p><i>An assessment should be made as to whether the private sector would be capable and willing to involve itself in the project as a PPP. Capability to fulfil the project requirements might depend on factors such as the availability of relevant skills, technical ability, the size of the market and the level of interest of financial markets in funding the projects.</i></p> <ul style="list-style-type: none"> <i>This will require a subjective assessment, rather than an formal approach to the market.</i> <i>Research should be done into other examples of this type of asset being procured under a PPP arrangement previously, in other jurisdictions and/or overseas.</i> 			
	If the project were a PPP would it be a real business opportunity that would be likely to attract a number of competent bidders?				

Assessment Summary:

A summary should be given on the overall conclusions of the PPP suitability assessment.

- Particular reference should be made to the business driver for the project and whether or not this is likely to be compatible with a PPP arrangement.
- Where other project characteristics, not listed above, are of importance to this assessment these should also be stated here.

Submissions to government should include at a minimum this assessment summary of PPP suitability.

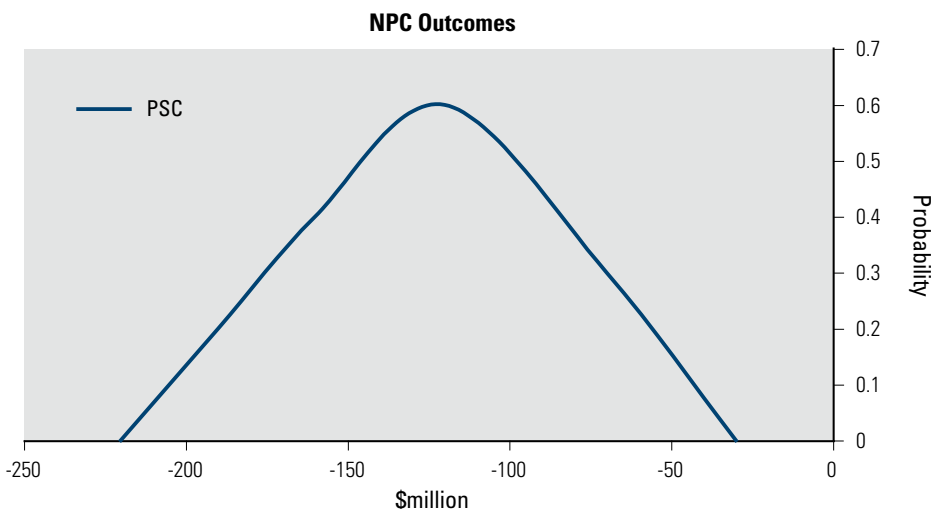
C Quantitative Value for Money Comparison and Sensitivity Analysis

This Appendix uses a hypothetical case of a PSC to illustrate the quantitative value for money comparison process and the importance of sensitivity analysis. The guide makes it clear that the calculation of the PSC net present costs (NPC) involves the forecasting of inherently uncertain future values, and that the value for money analysis therefore cannot be reduced to a single point comparison of two numbers. Sensitivity analysis takes account of the uncertainty inherent in the forecasts by varying the key inputs on which the PSC financial model is based and analysing the effect on the NPC outcome.

The range of variations applied to the inputs can be derived from various sources such as historical data, interviews with experts or risk workshops attended by all project stakeholders as well as risk specialists. A relevant example would be the expected maintenance costs for a plant or facility. The data would be captured as the range of possible cost outcomes for this item together with a probability distribution indicating the likelihood of each possible outcome within the range. Computer software is then used to carry out simulations of the combined impact of these cost outcomes and their associated probabilities on the final NPC of the project. There are various specific methodologies used by practitioners in applying this procedure, which is known as Monte Carlo simulation. The technique is relatively sophisticated, and agencies interested in its application may need to engage financial advisers.

Sensitivity analysis should also be applied to the discount rate because it can change while the project is being evaluated. A range of $\pm 1\%$ at 0.25% increments is recommended for this analysis.

The final results of a Monte Carlo simulation can normally be summarised in a graph similar to the one below:



Quantitative Value for Money **C**

Comparison and Sensitivity Analysis

This example demonstrates that there are a range of possible outcomes with associated probabilities for the final NPC of the project. Therefore, in addition to the qualitative comparison of outcomes, the value for money recommendation in this case should also consider:

- The relative “tightness” of the probability distribution, i.e. the likelihood that the actual outcome could deviate from the mean NPC. For the Business Case the presentation of the results could for example include the mean NPC together with an upper and lower limit within which the actual outcome could reasonably be expected to occur; and
- The impact of the discount rate sensitivity analysis.

There are also qualitative factors which should be considered in estimating the private sector response in a PPP project. These include:

- the level of private sector competitive interest in the project; and
- the potential for private sector efficiency savings, third party use and innovation.

D Project Development Checklist

Stage 1 – Project Strategy

Scoping Study

Activity	Tick	Consideration	Tick		
			Yes	No	N/A
Identify the Service Need		Does the service need require a significant asset procurement? Can the service need be defined in terms of output requirements?			
Define the Project Scope		Has the full requirement been identified? Have the key stakeholders been identified?			
Outline Delivery Options		Has a preliminary cost and risk analysis been undertaken? Are there any constraints (e.g. security considerations / political sensitivities/ environmental issues) and have they been addressed?			
Obtain Government Approval for Project		Has a case been made and has it received internal approval?			

Project Development Checklist **D**

Stage 2 – Project Options

Outcome: Interim Business Case

Activity	Tick	Consideration	Tick		
			Yes	No	N/A
Establish Project Management Structure		<p>Has a project team (Steering Committee, Project Director, procurement team) been identified and assigned?</p> <p>Have team roles and responsibilities been clearly defined?</p> <p>Have appropriate team skills been identified and plans made to secure them?</p> <p>Has government expertise been considered?</p>			
Project Scope		<p>Does the requirement need to interface with existing provisions/projects?</p> <p>Does it specify clear outputs/deliverables?</p> <p>Does it seek to achieve value for money?</p> <p>Does it allow for innovation/efficiency gains?</p>			
Stakeholder Communications		<p>Have all key stakeholders been identified?</p> <p>Have communication channels with the stakeholders been established?</p>			
Project Plan		<p>Have all key stages of the project been clearly identified?</p> <p>Has sufficient time been allowed for each stage?</p> <p>Does the Project Plan provide a clear stage-by-stage audit trail showing all key decisions and actions taken?</p>			
Risk Analysis		<p>Have all risks been identified and allocated?</p> <p>Has a Risk Register been prepared?</p> <p>Is there a risk review mechanism in place?</p> <p>Has a quality assurance procedure/system been built into the process?</p> <p>Have stakeholders and specialist risk advisers been consulted?</p> <p>Have qualitative risks and benefits been adequately considered?</p>			

D Project Development Checklist

Outcome: Interim Business Case (continued)

Activity	Tick	Consideration	Tick		
			Yes	No	N/A
Develop PSC		<p>Have all whole-of-life costs been taken into account?</p> <p>Have costs been benchmarked and/or market tested?</p>			
Market Support and Public Interest		<p>Is there sufficient market interest/capability to ensure healthy competition?</p> <p>Is the extent of competition considered adequate?</p> <p>Have any public objections been satisfactorily dealt with?</p>			
Quantitative Assessment		<p>Have the key risk assumptions and cost components of the PSC been identified?</p> <p>Has sensitivity analysis been conducted to support the value for money conclusion?</p>			
Qualitative Assessment		<p>Have sufficient resources been given to the qualitative assessment?</p> <p>Have all possible qualitative factors been considered?</p> <p>Has the PPP Suitability Checklist been completed?</p> <p>Has an assessment summary of PPP suitability been included in the Business Case? If the Checklist indicates PPP Suitability has the allocation of the key risks between the public and private sectors been adequately considered?</p>			
Submission to Government		<p>Has a case been made on the preferred delivery option and has it been approved?</p> <p>If PPP is not preferred, is the PSC a practical alternative?</p> <p>Does the submission adequately inform government of each of the above factors?</p>			

Project Development Checklist **D**

Expression of Interest

Activity	Tick	Consideration	Tick		
			Yes	No	N/A
Develop EOI Documentation		Has probity adviser/auditor been engaged? Can existing frameworks be used? Has the appropriate template been used? Has it been tailored for the specific requirement? Has it been quality assured, subject to probity review?			
Publish EOI		Have all interested parties received the same information and at the same time? Has all relevant information been supplied? Have all documents been included? Have clear instructions been given for EOI return? Are clarification meetings necessary?			
Evaluate EOI		Have proper EOI handling (i.e. receipt and opening) arrangements been agreed? Has the agency abided by all necessary probity requirements? Has sufficient time been allowed for the process? Has the evaluation model been tested? Has it been quality assured? Is there a proper audit trail of the process? Has the appraisal involved all the relevant specialists and stakeholders?			
Report to Steering Committee		Has approval of shortlisted tenderers received sign-off by the Steering Committee and legal advisers (where appropriate)?			
Public Works Committee Submission		If required, has a submission been referred? Has sufficient time been factored into the Project Plan for the PWC consideration of the submission?			

D Project Development Checklist

Request For Tender

Activity	Tick	Consideration	Tick		
			Yes	No	N/A
PSC Disclosure		Have any substantive arguments been put forward for not disclosing PSC data?			
Development of the Project Brief		Can existing frameworks be used? Has the appropriate template been used? Has it been tailored for the specific project? Has it been quality assured? Have all documents been included? Have clear instructions been given for tender return? Have areas for negotiation been identified and a strategy and team structure agreed? Are site visits, references, presentations or interviews necessary? Has the probity auditor issued a report on the Project Brief?			
Project Contract		Has consideration been given to the most appropriate type of agreement/contract? Has the draft contract been legally approved?			
Formal Bid Evaluation		Has an Evaluation Team been established? Have proper tender handling (i.e. receipt and opening) arrangements been agreed? Has the tender evaluation plan been approved? Has sufficient time been allowed for the process? Has value for money been realised?			
Preferred Tenderer Identified		Can a preferred tenderer be identified or are there sufficient outstanding issues (or inseparability) to warrant a Best-and-Final-Offer (BAFO) process?			

Project Development Checklist **D**

Final Business Case

Activity	Tick	Consideration	Tick		
			Yes	No	N/A
Final Business Case		<p>Has market consultation and feedback led to a review and update of the Interim Business Case and supporting schedules (e.g. Risk Register)?</p> <p>Has sensitivity analysis been undertaken on the finalised PSC financial model?</p> <p>Have bids been compared to the finalised PSC?</p> <p>Does a PPP arrangement deliver value for money?</p> <p>Has project scope been finalised and incorporated?</p> <p>Does the Final Business Case support the conclusion of the RFT stage?</p>			
Submission to Government and Decision		Has approval of preferred tenderer and supporting documentation received sign off by Steering Committee, legal advisers (where appropriate) and government?			

Negotiate with Preferred Tenderer

Activity	Tick	Consideration	Tick		
			Yes	No	N/A
Contract Finalisation		<p>Upon issuing decline letters has an offer been made for a debrief?</p> <p>Has the debriefing strategy been properly planned and cleared?</p> <p>Has security clearance of preferred tenderer/s been obtained?</p> <p>Has a negotiation strategy been agreed?</p> <p>Have preparations for financial close been made?</p>			

E Glossary

Term	Definition
Business Case	A proposal that describes the justification for pursuing a project according to a certain delivery option and establishes a value for money recommendation as to the most appropriate procurement approach. It also provides key details about the project, expected costs and the associated budget impact. It is updated at key points throughout the project assessment stage.
Communications Strategy	The definition of how the project's objectives, plans and progress are to be communicated to the various stakeholders involved in the project and how the stakeholders' views and input will be received and taken into consideration.
Competitive Neutrality	Competitive Neutrality adjustments remove any net advantages (or disadvantages) that accrue to a government business simply by virtue of being owned by government.
Contractor	The private sector entity or consortium with which government directly contracts. Traditionally the contractor has been a Special Purpose Vehicle created specifically for the purposes of the project. The contractor is not, however, limited to this form and may set up under other structures, e.g. a trust. Supporting the contracting party is generally a number of other sub-contracts for the provision of necessary elements to the project (e.g. facilities management, maintenance, operation, construction, debt provision etc.).
Delivery Option	The range of possible methods of acquiring the assets necessary to meet the service requirement. Each possible arrangement will vary in risk sharing and partnership arrangements.
Discount Rate	The percentage rate applied to cash flows to calculate the present value of future cash flow streams to enable comparisons to be made between payments made at different times. The rate quantifies both the time value of the future cash flow streams and the risk of the relative cash flow streams.

Glossary E

Term	Definition
Discounted Cash Flow (DCF)	Discounted cash flow analysis involves forecasting all revenue and cost cash streams (including capital expenditure) for a project into the future. The stream of cash flows is discounted to estimate the value of the project in today's dollars.
Expressions of Interest (EOI)	Responses to an open approach to the market requesting submissions from interested in participating in a procurement. Responses to the EOI are used to evaluate the capability of tenderers to deliver a project and may be used to gather some information from tenderers on particular approaches that may be accommodated in the Project Brief. The list of potential suppliers who have submitted responses may then be used as the basis for conducting a select tender process.
Government Business Enterprise (GBE)	A commercially focused government-owned trading body constituted under Australian Government legislation and/or Corporations Law as a separate legal entity.
Government Department or Agency	A government controlled entity prescribed under the <i>Financial Management and Accountability Act 1997</i> . Noting that government entities subject to the <i>Commonwealth Authorities and Companies Act 1997</i> can also adopt the PPP framework in assessing delivery options on a voluntary basis.
Net Present Cost (NPC)	The equivalent cost at a given time of a stream of future net cash outlays (calculated by discounting the values at the appropriate discount rate).
Net Present Value (NPV)	The future cash flows, discounted for timing and risk, less the cost of investing in the project calculated in terms of today's worth.
Preferred Tenderer	The preferred tenderer is a tenderer selected to develop its proposal during the negotiation period in sufficient detail to enable the execution of the final contract.

E Glossary

Term	Definition
Public Private Partnership (PPP)	PPP is a form of procurement involving the use of private sector capital to wholly or partly fund an asset that would have otherwise been purchased directly by the public sector and which is used to deliver public sector outcomes.
Probity	Uprightness, honesty, proper and ethical conduct and propriety in dealings. Used by government to mean 'good process'.
Project Brief	The Project Brief details government's objectives, service delivery requirements, policy and commercial matters, material background information and the processes for lodging and evaluating submissions. It also sets out the agency's role and intentions, and explains how 'checks and balances' are observed in the evaluation process to ensure impartiality.
Project Contract	The Project Contract is the legally binding document for the PPP project and is a companion document to the Project Brief.
Project Director	The individual responsible for the day-to-day management and delivery of the project. The Project Director reports to the Steering Committee.
Project Plan	The description of the project's activities including a schedule of when they will happen and what each activity will deliver.
Project Scope	The project scope sets out the range of services that government is seeking to procure and the performance levels required for each of those services.
Property	Every type of right, interest or thing which is legally capable of being owned. This includes, but is not restricted to, physical goods and real property as well as intangibles such as intellectual property, contract options and goodwill.

Glossary E

Term	Definition
Public Sector Comparator (PSC)	A benchmark against which value for money (VFM) of private sector bids are assessed. It is typically a cost estimate based on the assumption that assets are acquired by government through conventional funding and that government retains significant managerial responsibility and exposure to risk.
Raw PSC	The base costing of the Reference Project underlying the PSC. It does not include any allocation of value for risks and contingencies, which may affect cash flows.
Risk	The chance of an event occurring that would cause actual project outcomes to differ from those originally assumed.
Risk Management	The identification, assessment, allocation, mitigation and monitoring of risks associated with a project. The aim is to reduce their variability and impact.
Risk Management Matrix	A method of presenting all possible significant risks likely to be encountered in a project, the magnitude and likelihood of the risks occurring, their areas of impact, the allocation of risks between parties and the risk mitigation techniques to be employed.
Risk Register	A central register of the identified risks to a project providing complete management information about the risks and their status at any point in time.
Stakeholder	An individual or group of individuals such as employees, directors, shareholders, service providers, consultants, and external organisations who have an interest in the project whether through their involvement with the project or because they will be impacted by its outcome.
Steering Committee	The group ultimately responsible for a project. Duties include defining the project, reporting to the government, recommending the release of tender documentation and the selection of the preferred tenderer.

E Glossary

Term	Definition
Traditional Procurement	Government's delivery of the project using a best practice but realistic model. Generally assumes government manages the procurement and provides finance. Individual components of the project may, however, be contracted to the private sector.
Value for Money (VFM)	Value for money is assessed through a comparative analysis of all relevant costs and benefits over the entire life cycle of the project, including the performance history of the supplier, the relative risk of the proposal, the flexibility to adapt to future changes, financial considerations and others as set out in the Commonwealth Procurement Guidelines. In the PF context in particular, it is derived through a comparison of traditional procurement versus PF procurement. Assesses which option delivers the required services to the public sector at the lower total cost, with consideration given to both qualitative (risk transfer) and quantitative (cost) measures.
Whole-of-Life Cost	The costs associated with design, construction, operation, maintenance and refurbishment of the underlying infrastructure asset over the term of the project.

For assistance with PPP project assessment, or for clarification of any part of this or other guidance issued by the Finance, please contact the PPP Unit.

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Websites

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