

# VERIFIED VERSION

## PUBLIC ACCOUNTS AND ESTIMATES COMMITTEE

### **Inquiry into Effective Decision Making for the Successful Delivery of Significant Infrastructure Projects**

Melbourne — 22 March 2012

#### Members

Mr N. Angus

Mr P. Davis

Ms J. Hennessy

Mr D. Morris

Mr D. O'Brien

Mr M. Pakula

Mr R. Scott

Chair: Mr P. Davis

Deputy Chair: Mr M. Pakula

#### Staff

Executive Officer: Ms V. Cheong

#### Witnesses

Mr K. Lavelle, Executive Director, Corporate Services,

Mr P. Crowe, Executive Director, Head of Origination, and

Mr D. Augustinus, Associate Director, Origination, Plenary Group.

**Necessary corrections to be notified to  
executive officer of committee**

**The CHAIR** — I declare open the Public Accounts and Estimates Committee hearing on the inquiry into effective decision making for the successful delivery of significant infrastructure projects. On behalf of the committee I welcome from the Plenary Group Mr Kelvyn Lavelle, executive director, corporate services; Mr Paul Crowe, executive director, head of origination; and Mr Damien Augustinus, associate director, origination. Members of Parliament, departmental officers, members of the public and the media are also welcome.

In accordance with the guidelines for public hearings I remind members of the public gallery that they cannot participate — there are not too many of those. Only officers of the PAEC secretariat are to approach PAEC members. I advise that TV camera operators are to remain focused only on the persons speaking and that panning of the public gallery, committee members and witnesses is strictly prohibited.

As previously advised to witnesses here today, I am pleased to announce that these hearings are being webcast live on the Parliament's website. All evidence taken by this committee is taken under the provisions of the Parliamentary Committees Act, attracts parliamentary privilege and is protected from judicial review. However, any comments made outside the precincts of the hearing are not protected by parliamentary privilege.

This committee has determined that there is no need for evidence to be sworn; however, witnesses are reminded that all questions must be answered in full and with accuracy and truthfulness. Any persons found to be giving false or misleading evidence may be in contempt of Parliament and subject to penalty.

All evidence given today is being recorded. Witnesses will be provided with proof versions of the transcript to be verified and returned within two working days of this hearing. Verified transcripts and PowerPoint presentations will be placed on the committee's website within two weeks of this hearing.

Following a presentation by the Plenary Group, committee members will ask questions relating to the inquiry. Generally the procedure followed will be that relating to questions in the Legislative Assembly. I ask that all mobile telephones be turned off.

I now call on Mr Lavelle to give a brief presentation of no more than 4 minutes, if desired.

**Mr LAVELLE** — Thank you, Mr Chairman, Deputy Chairman and committee members for the opportunity to address you here today. I would like to make an initial statement perhaps as a way of getting discussion started and succinctly covering some of the issues that were in our submission.

By way of background Plenary Group is a development and investment business in the social infrastructure PPP market in Australia. It was established in Melbourne in 2004. It exported its approach to Canada, and the business has become the largest dedicated PPP business in both countries. We have offices in Melbourne, Sydney, Adelaide, Singapore, Toronto, Vancouver and Edmonton. Plenary Group has delivered, or is in the process of delivering, 20 social infrastructure PPP projects in Australia and Canada. Our views are based on our expertise in the PPP infrastructure market.

In relation to Victorian infrastructure, our view is that this state has been at the forefront of infrastructure procurement over many years. The Victorian PPP tender process has historically been effective in generating very positive outcomes for government, including value for money, time and cost certainty, effective risk transfer, quality of construction and a whole-of-life service delivery — more so, we believe, than other procurement approaches.

Not surprisingly then, the Victorian PPP approach has been adopted by other jurisdictions, including Canada. Indeed one of the attractions of Plenary's establishment of the Canadian business was the adoption of the Victorian PPP approach by several Canadian provinces.

In Plenary's view the core skills, base, expertise and decision-making in our field of PPPs within the public sector is substantial. Here one of the unsung outcomes of the PPP projects has been the crosspollination of skills and knowledge between the public and private sectors. PPPs require a significant amount of planning and rigour in order to produce the exact brief up-front for the private sector to bid on, and the tender and delivery process for PPPs sees a significant amount of expertise and knowledge transfer between the public and private sectors, all of which is utilised by the public sector for delivery across other forms of public infrastructure procurement. We also see this crosspollination given effect by the movement of people between the two sectors.

Notwithstanding the challenges associated with the aftermath of the global financial crisis, the benefits of PPP projects for government continue to justify private sector participation. Indeed there is a growing body of research that endorses PPPs as a value-for-money procurement approach.

With regard to the facilitating effect of decision making in the delivery of major infrastructure, our view is a simple idea: that you get good at things by practising them and that achieving effective decision making on significant PPP infrastructure will rest on the exposure of the public sector to a steady stream of projects to deliver. Infrastructure markets are constantly evolving, and the state project teams across departments need to be exposed to the most recent procurement and delivery initiatives or risk their knowledge becoming dated.

At Plenary we know this to be the case because we were able to directly reference the experience of our business in Canada. In particular we raised the Ontario PPP market in the creation of Infrastructure Ontario in 2005, five years after the creation of Partnerships Victoria. While Partnerships Victoria now lists some 22 PPP projects in 12 years in various forms of delivery and operation, Infrastructure Ontario has undertaken more than 50 projects in seven years.

In achieving a continuous pipeline, the Ontario market has achieved a number of flow-on outcomes which we think are beneficial. It has attracted major international expertise and been able to nurture significant local skills and expertise. This growth in experience and expertise has allowed the government the confidence to standardise and streamline the bidding process and reduce costs for both the government and the bidders in PPP procurement. It has created a centre of excellence for infrastructure procurement and created confidence in the market and in the public's mind that the infrastructure gap is being closed in that province.

Importantly the Ontario deal flow and 10-year infrastructure planning process undertaken has seen enormous investor interest in the PPP market, which has in turn assisted price competition for financing and helped the local bond market rebound, still largely dormant in the PPP market in Australia post the global financial crisis.

In brief summary then, the single largest determinant of increased knowledge leading to effective decision making for delivery of significant infrastructure is a dynamic market and a strong pipeline of projects, in our view. This will create certainty and provide the platform to nurture local talent, as well as attract and retain the range of specialist expertise required.

We have seen the benefits of a strong PPP deal flow on decision making, skill development and investment attraction in other jurisdictions. We see it as critical that the state's management and administrative structures facilitate the retention of the state's PPP procurement corporate memory and enable them to apply lessons learnt to upcoming projects. We believe the approach taken by the Canadian province of Ontario to centralise infrastructure procurement expertise is a model that should be considered by the committee in its deliberations.

**The CHAIR** — I will jump in quickly and get clarification on some points you have made before going to a substantive question. In relation to Ontario you said 50 projects in seven years. What is the value of those projects? I do not mean in aggregate; I mean the composition or distribution value.

**Mr CROWE** — I am happy to answer that. Those projects range from quite small \$50 million projects to large billion-dollar projects. There is quite a spread; the average project size, if you sum them all up, is a bit over \$400 million.

**The CHAIR** — Can you advise the committee, because I do not know the answer to this — if I did, I would not be asking — if the accounting treatment in bringing to account the liability of the PPPs is a similar accounting standard to Australia or is there a different standard?

**Mr CROWE** — It is a similar accounting standard.

**The CHAIR** — In relation to describing your own business, what do you mean when you talk about 20 projects you have successfully been involved in? In your note you said \$9.5 billion for 19 projects; it might be a bit more than that now. Can you explain what you mean by 'successfully closed'? Are they completed?

**Mr CROWE** — That is being appointed preferred bidder then achieving a financial close. That is what we mean by 'successfully closed'.

**The CHAIR** — The key issue that we are focusing on and that you can materially help the committee with is the issue around the informed buyer — that is, we are trying to draw out of all our witnesses a view, which is inconsistent I could probably say, about whether or not the Victorian public sector is an informed buyer. I would like to get your take on that from your own experience in this state and your experience in other jurisdictions.

**Mr CROWE** — The Victorian government is a very informed buyer. They have a lot of expertise within different parts of government that is brought to bear on procurement here. So they are very informed.

**The CHAIR** — I not making a suggestion here, but implicitly I am saying that there is no doubt that it is in your interests to promote the ongoing use of PPPs and expand that because that is the field you are working in. I guess what we are really interested in is not so much the commercial relationship in terms of the net financial benefit to a proponent that is undertaking a PPP but really to get to a point of understanding, if you like, technical specification and agreement between the parties. Does the Victorian jurisdiction have sufficient intellectual capacity? If I use the best example, have we got enough people who have actually ever carried a nail bag and who can build something as opposed to the finance, legal and other general disciplines that are not related specifically to the hard edge of design and construct?

**Mr CROWE** — In procuring these sorts of projects we see that the government is quite capable of assembling the right expertise, whether that sits within government or is external to government. All procurement teams will generally get a number of those skill sets, such as finance and legal advice, externally. There is a mixed level of expertise within the departments themselves in terms of how heavily they rely on external expertise versus internal expertise in construction and specification of the project itself.

**Mr PAKULA** — Going to the issue of how informed the government is, we had another submitter from the construction sector yesterday or the day before who expressed the concern that what they would view as the necessary two-way dialogue between government and the construction sector in terms of those two bodies understanding each other properly can sometimes be adversely affected by probity requirements. In other words, government becomes so gun-shy of talking to industry as a result of probity requirements that this constructor at least thinks it acts almost as an inhibitor on a proper dialogue. I would be interested in hearing your view on that and whether you see it the same way.

**Mr LAVELLE** — I think we probably approach it a little differently. Again if we use the Ontario market as an example, I think what we have in that market is a level of centralisation and expertise within one agency that allows them to standardise the documentation process and agree, and feel confident that they can agree, on a winner of a PPP project earlier than possibly we do here — or definitely earlier than we do here. Rather than taking all three bids to the final step in the decision making and probity existing all the way through that, they are probably getting to about two-thirds or three-quarters of the process that we would have here and making a call on sort of acknowledging that, 'In all honesty we probably prefer bidder A in this instance. We can allow bidders B and C to go, keep them on hold and go into an exclusive negotiating period with bidder A', at which point — —

**Mr PAKULA** — So they determine the preferred tenderer earlier?

**Mr LAVELLE** — Much earlier — so you do not get that probity process going right to the nth degree. The state still gets all the benefits of risk transfer and an approach that is going to give you all the upside of a PPP, but it does so earlier and I guess starts that dialogue and negotiating period much earlier. So a number of those probity issues start to fall away much earlier in their process.

**Mr ANGUS** — I will just go back to some of the line of questioning from the Chair at the outset. Would you mind explaining a little bit more, for the sake of the committee, the operation of your business, Plenary Group, and its specific role? You mentioned that it is involved in PPPs, and your document says 'various aspects'. I am trying to drill down a bit to find out what the role of your business is on an ongoing basis.

**Mr CROWE** — Yes, I am happy to take that question. We are primarily a developer and investor in PPPs. Within the procurement of infrastructure there are different phases of the procurement life cycle. We are involved in bidding and trying to secure projects to invest in. We are then involved in asset management and delivery, and we are also involved in the investment management side of asset management, where we invest in

our own capital, and we have co-investors that invest alongside us and rely on our asset management capabilities.

**Mr ANGUS** — Thank you. That is very helpful. In terms of PPPs that are up and going that you have had an ongoing relationship with, could you just tell me how long you have been involved? What is the oldest one you have going? You mentioned the Canadian jurisdiction. Are there any other jurisdictions where you are seeing this as a model or you are looking to target it as a model to get it going?

**Mr CROWE** — Casey Hospital here in Victoria is probably the oldest PPP that we have been involved in since establishing Plenary. Obviously Plenary's directors were involved in various previous lives in other projects, but that is the oldest. We have seen the take-up of the PPP model across Canadian provinces and federally given the success of Ontario's delivery of projects by that procurement model. We are also seeing a lot of interest in the United States and differing interest across the different 50 states for how they could avail themselves of PPPs. We have seen a lot of interest in Asia. As you can imagine, PPPs in Asia come with sovereign credit issues, and a lot of the PPPs there are delivered with the involvement of either the Asian Development Bank or the World Bank, so it is not necessarily a traditional PPP market, but it is starting to occur there as well.

**Mr ANGUS** — Given your longstanding history here in Victoria, then, are you seeing that the government has the skill sets on an ongoing basis to deal with you guys in terms of the services that are required and the skill sets on the government side? So it is not just the front end, but it is on an ongoing basis.

**Mr CROWE** — There are skills within government to deliver and manage these projects, but like anything, there are varying experiences, particularly when there are changes in personnel on the government side in terms of who the contract administrators are and how that knowledge transfers to a new contract administrator. There are definitely things there that could be done better in terms of retaining knowledge instead of a new contract manager coming in without the benefit of the retention of the knowledge from previous experience. There is a varied amount of experience in that.

**Mr LAVELLE** — One of the issues we have come here with — I guess it is our agenda before the committee — is that we sometimes feel like the public sector loses some of its corporate memory around PPP procurement. If you purchased a PPP project three years prior and are now attempting to procure a PPP project, your knowledge and expertise is going to be quite dated. Three years in this market is an enormous period of time. It could take you from pre-GFC to post-GFC in some instances. What we are seeing in other markets, particularly Ontario, is a centralised approach to the procurement of infrastructure, PPP and other infrastructure, where I guess that sort of state expertise or corporate expertise is retained much better, so that you have got, as I have said, a centre of excellence, if you like, in an agency that is in what we would know as the outer budget — or not even the outer budget; I think Infrastructure Ontario is funded by a development fee on the client department.

So what you see there is just a much more consistent approach, much more certainty in the marketplace for bidders and the state, and I guess in part a little bit more certainty or confidence even in the public mind that there is an agency that is a little bit separate from government itself managing the delivery and purchase of infrastructure. That is why we thought our submission to you was useful in that regard. We know that in some senses we come from a narrower sphere of expertise than other submission writers, but whilst it is narrower to the broader economy it is very special to us, and we think it is quite important for infrastructure procurement more generally that you get that level of expertise, I suppose, held within government.

**Mr AUGUSTINUS** — If I could just add to that, Kelvyn, one thing we have seen in Infrastructure Ontario is that it did start very much focused on what we call the PPP market, but in fact the government has seen the body of experience and expertise built up there. It has become such a centre of excellence that in fact they have given it much broader responsibility going forward. So now it is taking over all infrastructure procurement effectively in place of a department of works type thing. I suppose it is able to bring the track record and experience that is built in a PPP world and apply it across all of the government infrastructure spend. That is a demonstration of the value they have seen in that centralisation, initially focused on PPPs but now being able to be applied more broadly.

**The CHAIR** — You mentioned Asia on the way through. Whereabouts in Asia? What was the particular reference?

**Mr CROWE** — It is just seeing the initial signs of a PPP market in South-East Asia, but given the credit quality of the sovereigns in South-East Asia there has been a lot of difficulty in doing anything under a sort of PPP-type model that did not involve the Asian Development Bank or the World Bank. There have been some projects delivered in Singapore, and they have continued to look at Singapore, particularly within the water resources sector for Singapore, which is where they have used the model.

**Mr SCOTT** — You have touched upon the benefits of an infrastructure pipeline. Could you provide some more information to the committee about the particular benefits for skill retention both within the public and private sector that come from having that regular pipeline you have experienced, particularly in Ontario?

**Mr CROWE** — I think the benefits of the pipeline around skill retention are really about that different phases of these projects require different skill sets. The procurement of infrastructure, whether via PPP or another form, is particularly difficult and challenging and requires certain skills, and generally these people go from project to project. If Victoria is only in the market procuring sporadically in terms of infrastructure, that expertise will not generally be among Victorians; that expertise will be from trying to procure from other market places when we need it. The primary benefit we see is to have a skill base here by having a sort of ongoing commitment to infrastructure delivery and procurement.

**Mr SCOTT** — On the benefits as well as the different aspects of the infrastructure pipeline, you have talked about savings, particularly in terms of bids and ongoing PPP processes. Do you have an order of magnitude of what you believe the rough savings would be?

**Mr CROWE** — It is probably only in the research paper. There has been some research done by the University of Melbourne, I believe, which has looked at savings comparisons between PPPs and alliancing, as a comparison.

**Mr LAVELLE** — Yes, I do not have the chart here with me, but I think I know it pretty well. It looked at a number of alliance contracts in Australia and compared those to PPPs and D and C and, I would have to source the exact material, but I think it looked at alliance contracts at around a 50 per cent increase from initial cost estimates; design and construction at around a 20 per cent increase from initial cost estimates; and PPPs at only around 6 per cent from initial cost estimates.

**Mr SCOTT** — Sorry, with the Chair's indulgence, I actually meant that you stated that there were some savings gained if you had a regular ongoing series of projects in terms of bidding costs and the cost of participating in the market. It is a slightly different question; sorry I did not express myself clearly.

**Mr CROWE** — I misunderstood the question. I think the simple order of magnitude answer that I can provide, which is probably only indicative of that, is that we see bid costs in Australia for bidders to participate — and I would assume that governments face similar costs on their side of procuring — of around 1.5 to 2 per cent of the capital costs here. We see bid costs in the Canadian market of about 0.5 to 0.75 per cent.

**Mr SCOTT** — Does that lead to a greater number of participants in the market in the Canadian context?

**Mr CROWE** — Correct.

**Mr LAVELLE** — And of course more projects because the big costs are less and governments can do more.

**Mr AUGUSTINUS** — I guess looking across the spectrum we are seeing greater competition, so not only have we seen a lot of European and US contractors enter the Canadian market — and obviously the more competition, the greater value for money achieved by government — but also, on the investment side, aside from the Canadian pension funds, which I guess have always had a latent interest in the sector and have become a lot more active, European investors are moving heavily into that market. Likewise, in relation to the debt capital markets, when you look at the overall cost of capital, which feeds through to the cost of government, it has actually reduced, given that increased pipeline deal flow has meant that overall there is a lot more competition, and I think overall the costs have come down for government. I have not seen the precise numbers

on that, but even just looking at things like the cost of funding and debt margins and those sorts of things that we have seen in Canada, as the pipeline has grown certainly they have shrunk quite considerably.

**Mr O'BRIEN** — Thank you for your evidence. It is commendable that a group which is involved but perhaps could be criticised for having a potential commercial interest is nevertheless prepared to come along and give evidence to a committee with that in mind, notwithstanding that it will obviously not affect your future prospects. Having said that, there is one issue I would like to identify, if we are working on the assumption that you believe PPPs are a valuable model that should be, in a sense, promoted in Victoria. We had some evidence that PPPs are more suitable to certain types of government departments or certain types of projects and are perhaps more successful particularly in rollouts of steady, departmental-type work, like schools et cetera, where there is perhaps also a desire to have the downstream maintenance costs brought forward, and that allows for more projects and the ability to gain the expertise and retain it within that department or within the government generally. If we are looking at furthering the growth of PPPs in Victoria, is that where we should head, in your opinion, as opposed to the one-off contracts that may be more alliance-based or may need to be considered in a different category? Could you get into that issue for us?

**Mr CROWE** — I am happy to respond to that. I think by contrast to what we see in Canada, Canada has not seen that PPPs are only usable for a certain type of procurement, so that is why we say the range of the project sizes that we see in Canada can be from 50 to multiple billions. I think the benefits of PPPs are that there is a lot of up-front rigour that goes into the process of tendering for a PPP versus tendering in other forms; you get the benefit of certainty around what the departments are trying to procure and then a risk transfer off the back of that. A lot of rigour needs to go into that up-front effort, irrespective of what is being procured.

We also see a lot of benefits come into long-term maintenance and long-term asset quality. So in a PPP procurement, whether it is for 20 or 25-year maintenance contracts, a lot of effort has gone into understanding that risk and ensuring that the construction or the maintenance response is appropriate to managing that risk.

The third area where we see a lot of benefits coming to the fore is around innovation. We see projects such as the Royal Children's Hospital where a competitive tendering process led to some innovations that perhaps the government department would not have considered if it was procuring it under a different format.

For us, we do not see the need to limit the model to 'It should only be schools' or 'It should only be hospitals'. We think the model is quite flexible and there are benefits that can be brought to transport projects and water resource projects, and we see assets within different sectors being procured and in different jurisdictions all around the world.

**Mr O'BRIEN** — I have a supplementary question on a related issue or a similar issue, and looking at the relation between alliance contracts and also the level of business case evaluation up front. In particular, for example, if there are a number of projects that have not gone well one way or another, and it may have been that there was a blow-out in costs, not on time and on budget, or it may have been that the scope was not well defined in the sense that there is a view that the project was not needed — and in Victoria's history that may be more under alliances than PPPs — what is the impact of reputational disadvantage to Victoria's ability to carry out major projects from having blow-outs on costs or projects that might not have been needed in terms of the sense of value by the community? Are you able to help us there?

**Mr CROWE** — Within the investor community or the development community, on infrastructure the risk of the reputational damage is more around failed procurement in the actual procurement itself rather than if there are projects that are done by alliancing and the alliance model was chosen because there was not enough time or not enough ability to define the scope sufficiently to go down a PPP process where you do need a very clearly defined scope. Those projects may not have failed in terms of our view or may not have shown a sign of failure, because there was subsequently a construction blow-out due to a different risk that someone did not account for, which emerged later on.

The investor development market understands that there are risks in these projects, and we see projects that, whilst they get reported as failures, are not necessarily failures; there is just an emergence of risks that were either accounted for or inappropriately accounted for, but they do lead to potential time and cost blow-outs.

**Mr O'BRIEN** — I suppose there is a broader view of the community as well, which government comes from, of which the investor segment is an important part.

**Mr CROWE** — Yes.

**The CHAIR** — Regrettably we are out of time. I thank you all for your attendance today and the evidence you have given. There was a question about some reference to a University of Melbourne research paper. If it is possible, could you send us an email advising what that research was?

**Mr LAVELLE** — It was research that was partly sponsored by Victorian Treasury, so it is actually on the Treasury website.

**The CHAIR** — Right; that is fine.

**Mr PAKULA** — It is either the Treasury research or Treasury has plagiarised it, because it is exactly the same.

**Mr LAVELLE** — It is *In Pursuit of Additional value — A Benchmarking Study into Alliancing in the Australian Public Sector*, Melbourne University, Evans and Peck, and the Inter-Jurisdictional Alliancing Steering Committee.

**The CHAIR** — I have got it; thank you very much. That concludes our interaction. I do not think there are any other outstanding issues, so thank you very much for your attendance. That closes the hearing.

**Witnesses withdrew.**