

Chair
Cabinet Economic Growth and Infrastructure Committee

ENABLING THE PROCUREMENT OF TRANSMISSION GULLY USING A PUBLIC PRIVATE PARTNERSHIP

Proposal

1. This paper seeks Cabinet's approval for the NZ Transport Agency to:
 - 1.1. pursue procurement of the Transmission Gully project through a Public Private Partnership
 - 1.2. borrow up to the estimated costs of traditional procurement (the Public Sector Comparator) as part of the Public Private Partnership.
2. These approvals will enable the NZ Transport Agency to move to the next stage of the procurement of the Transmission Gully project.
3. Once the outcomes of the NZ Transport Agency's procurement process are known, the final approval of the borrowing limit will be confirmed by Cabinet before the NZ Transport Agency awards the contract.

Executive summary

4. The government is seeking to maximise the efficiency of public sector procurement processes. Public Private Partnerships have been identified as a potential mechanism for achieving value for money across the public sector. The potential of Public Private Partnerships is assessed on a case-by-case basis.
5. Cabinet has invited the Minister of Transport to evaluate the potential of Public Private Partnerships as a procurement model, within the broader context of National Land Transport Fund pressures. The NZ Transport Agency has been asked to consider the potential use of Public Private Partnerships for current projects.
6. The Agency identified the Transmission Gully project as the best candidate for a Public Private Partnership. The construction of Transmission Gully is currently scheduled to commence in 2014/15. A Public Private Partnership approach enables the NZ Transport Agency to maintain the existing construction schedule.
7. The Board of the NZ Transport Agency has approved the construction of the Transmission Gully project, in accordance with its responsibilities under the Land Transport Management Act 2003. The Board considers that a Public Private Partnership is a viable proposition for this project. Cabinet's approval is now required, in order for the NZ Transport Agency to proceed to the next stages of procurement.

8. The benefits of procuring the Transmission Gully project through a Public Private Partnership are as follows:
 - 8.1. there is a reasonable probability that a private sector consortium will be able to beat the estimated cost of the Public Sector Comparator through innovative design and operation, and more effective risk management
 - 8.2. there are likely to be further benefits to the NZ Transport Agency, and other road controlling authorities, from applying learnings from the Public Private Partnership, such as new solutions and approaches (including to risk management), to the wider network.
9. It is intended that the Public Private Partnership procurement process would occur in 2013. We would report back to Cabinet prior to signing the contract, confirming the value for money proposition and the maximum borrowing amount. It is expected that the final contract could be awarded by the NZ Transport Agency in 2014/15, with construction commencing soon afterwards and completed in 2019/20.
10. Under a Public Private Partnership, the private consortium finances the construction of the project. In return, the NZ Transport Agency commits to paying a service payment for 25 years once the road is available in 2019/20. This commitment is treated as a debt which requires borrowing approval under the Crown Entities Act. The total level of debt is expected to peak at around \$1.32 billion in 2019/20, on an actual cost basis. This debt does contribute to total Crown debt and as such impacts on the Crown's balance sheet and its reported net worth. However, we consider that the procurement benefits for this specific project and NZ Transport Agency outweigh the debt issues.
11. The NZ Transport Agency is also developing a proposal to offset some of the costs of the project through tolling. Withheld under section 9(2)(j)
12. The NZ Transport Agency will consider the potential for procuring other projects through Public Private Partnerships. Each of these proposals would be submitted for Cabinet's consideration and approval on a case-by-case basis.

National Land Transport Fund: Future Funding

13. On 20 August 2012, the Minister of Transport reported to the Cabinet Economic Growth and Infrastructure Committee on the gap between expected revenue for the National Land Transport Fund and the expenditure required to deliver the Roads of National Significance programme on schedule and to meet the other expenditure targets set in the *Government Policy Statement 2012/13 – 2021/22*.

14. A proposed funding package to address the gap between revenue and expenditure has now been prepared. It is outlined in a separate Cabinet paper “National Land Transport Fund: Future Funding”, which is being considered alongside this paper. That paper recommends:

14.1. [Redacted] Withheld under section 9(2)(f)(iv)

- 14.2. the consideration of longer term borrowing proposals, such as Christchurch roading reinstatement and the procurement of Transmission Gully through a Public Private Partnership, on a case by case basis.

NZ Transport Agency Board decisions

15. On 28 September 2012, the Board of the NZ Transport Agency (the Board) considered the detailed business case, and assessed the Transmission Gully project in accordance with its statutory responsibilities under the Land Transport Management Act 2003.
16. The Board approved construction and concluded that the project demonstrated an acceptable value for money proposition for contract delivery through a Public Private Partnership procurement model in accordance with the Treasury’s guidelines¹. The Board resolved to seek the approval of the Minister of Finance and Minister of Transport to borrow for the procurement of the Transmission Gully project through a Public Private Partnership.

Decisions sought from Cabinet

17. Because all Public Private Partnership proposals can have significant fiscal and policy implications and can affect the government’s reputation, Cabinet must have the opportunity to engage with all proposals by Departments or Crown agents, such as the NZ Transport Agency [CO (10) 2 refers]. In order for the NZ Transport Agency to proceed to the next stage, Cabinet’s approval is sought for the NZ Transport Agency to pursue procurement of the Transmission Gully project through a Public Private Partnership, on the basis that the resulting proposal will achieve value for money expectations and support the government’s strategic objectives for transport.
18. As joint ministers, we must also give approval for the NZ Transport Agency to borrow for the purposes of Public Private Partnership procurement under section 160(1)(b) of the Crown Entities Act 2004. We support this proposal and we are asking Cabinet to agree that the NZ Transport Agency may borrow up to the estimated cost of the Public Sector Comparator for the Transmission Gully project.
19. Subject to Cabinet’s agreement to the recommendation in this paper, the NZ Transport Agency will be able to proceed to the next stages of procurement, through to the negotiation of contractual terms with the preferred bidder.

¹ Guidance for Public Private Partnerships (PPPs) in New Zealand, October 2009, National Infrastructure Unit, The Treasury

20. Before the Public Private Partnership contract is awarded by the NZ Transport Agency, we will report back to Cabinet on outcomes of the procurement process. The details of the borrowing approval under the Crown Entities Act 2004 will also be confirmed at this time.

The case for Public Private Partnership procurement of Transmission Gully

21. The procurement of the Transmission Gully project through a Public Private Partnership will support the government's strategic objectives for transport.
22. Firstly, the project offers a value for money proposition. If bidders are unable to beat the estimated cost of the NZ Transport Agency procuring the project under its traditional procurement model (the Public Sector Comparator), the NZ Transport Agency will not proceed with a Public Private Partnership.
23. Secondly, it will provide an opportunity for the NZ Transport Agency to learn new innovative approaches to procurement, design, operation and risk management, and apply these across the wider network, lifting the value of the NZ Transport Agency's overall investment.

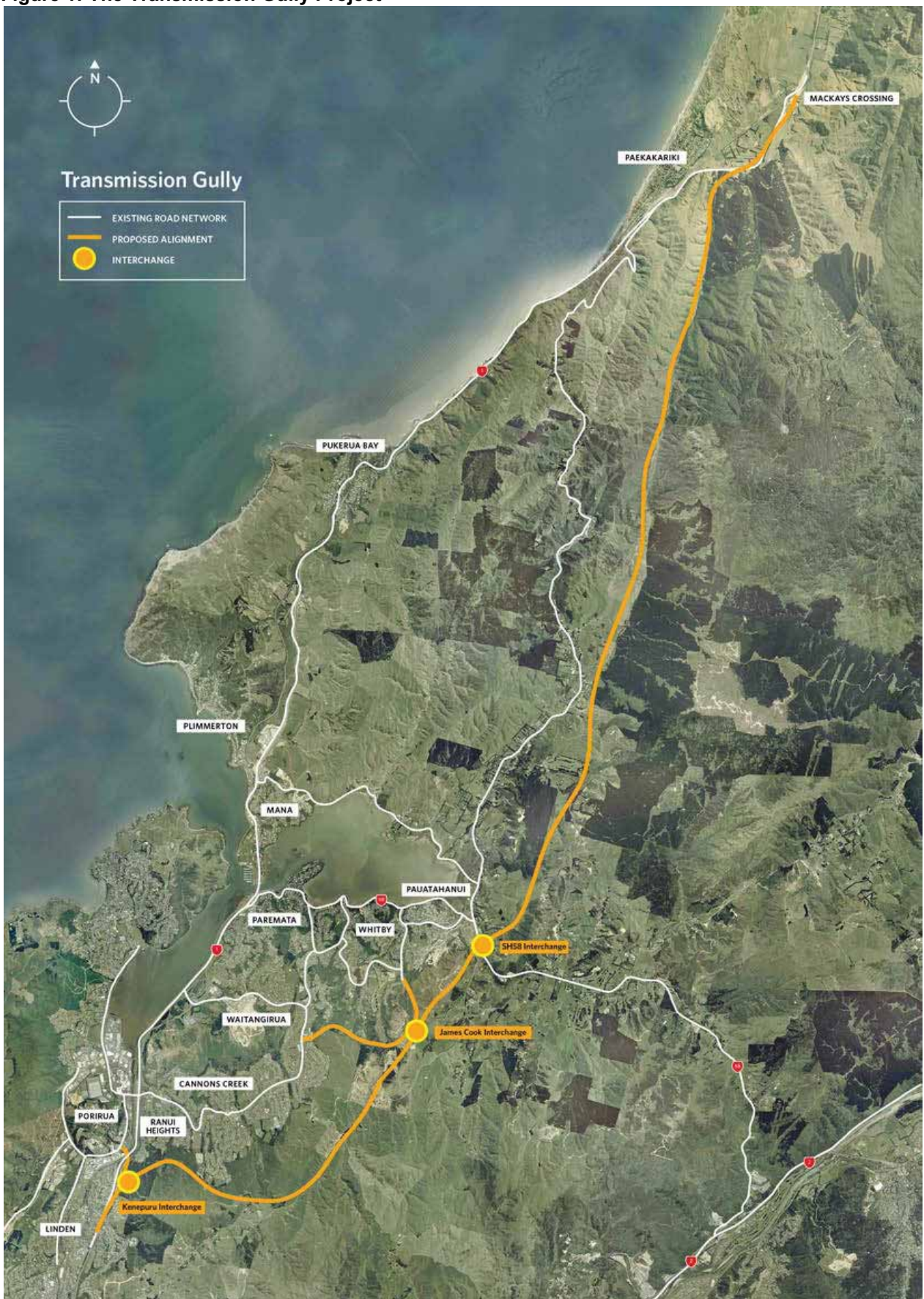
Background

24. The Transmission Gully project has been considered as an alternative route to the existing State Highway One corridor north of Wellington between Linden and MacKays Crossing (see Figure 1) for over 70 years. Transmission Gully is a part of the Wellington Northern Corridor, which was identified as one of the government's Roads of National Significance in the *Government Policy Statement 2009/10 – 2018/19*. The Wellington Northern Corridor would relieve congestion at peak times and improve commuter and freight trips through the corridor with better journey time reliability.
25. On 12 June 2012 a Board of Inquiry, appointed by the Minister for the Environment, approved the resource consents and the notices required for the Transmission Gully project. The project is now ready to move into the next stage of detailed design and construction.

Detailed Business Case

26. The NZ Transport Agency has prepared a detailed business case for the Transmission Gully project. This business case confirmed the strategic and economic case for the project and compared the benefits of a Public Private Partnership procurement approach to the NZ Transport Agency's traditional procurement approach.
27. The project team included representatives from the Treasury's Public Private Partnership team, along with external advisors from PricewaterhouseCoopers. Members of the Department of Corrections' Wiri Prison team were also consulted and the detailed business case was independently reviewed by Cameron Partners.

Figure 1: The Transmission Gully Project



Value for money assessment

28. One of the key premises of undertaking Public Private Partnership procurement is that it must offer greater value for money than conventional procurement approaches. This includes the consideration of both quantitative and qualitative dimensions of value for money. While the cost of capital for the private sector is higher than for the government, this cost of capital differential can be offset through private sector innovation and efficiencies in design, construction, operation and risk management (particularly where these are bundled together in one contract). Typically, the larger the project the greater the ability for private sector innovation and efficiencies to offset the cost of capital differential.
29. The NZ Transport Agency is confident that the Transmission Gully project offers sufficient scope and scale for private sector innovation, efficiencies and enhanced risk management to produce bids equal to or lower than the Public Sector Comparator:
 - 29.1. quantitative value for money is anticipated through the private sector applying innovative design and construction techniques, introducing greater operations and maintenance efficiencies, asset lifecycle optimisation and enhanced risk management (including in relation to time, scope and budget risks)
 - 29.2. qualitative value for money is anticipated through the private sector being held to account for enhanced road user safety and better travel outcomes
 - 29.3. further opportunities for value additions are expected through the NZ Transport Agency applying learnings from the Public Private Partnership to the wider state highway network and transport system.

The Public Sector Comparator

30. The Public Sector Comparator is the estimated cost if the Transmission Gully project were to be designed, built, financed and operated by the NZ Transport Agency. It is a means of informing the value for money assessment of bids. It is made up of three components: the “raw” cost of constructing and operating the project; a competitive neutrality adjustment; and the estimated cost of any risks that are transferred to the contractor.²
31. The Public Sector Comparator for the Transmission Gully project is estimated to be Withheld under section 9(2)(j) The nominal level of total debt for the project is expected to peak at around \$1.32 billion in 2019/20, on an actual cost basis, before regular payments to the private sector partner commence.
32. These estimates may change when the NZ Transport Agency re-estimates project costs before the Request for Proposals is issued to shortlisted bidders in March 2013.
33. The actual value for money proposition will not be known until proposals have been received and contract terms have been negotiated with the preferred bidder. The details of the value for money proposition will be presented for Cabinet’s review before the final borrowing approvals are confirmed.

² Examples of transferred risks are unforeseeable ground conditions and industrial relations disputes.

The performance regime and broader benefits to the network

34. The NZ Transport Agency would not make any payments to the selected consortium until construction is completed to the contracted quality standard and the project is available for use. Once payments commence, the contractor would be paid on the basis of specified performance criteria. These criteria will be determined as part of the final contract, but are likely to include, for example, payments based on:
 - 34.1. the time that the road (or specific lanes) is available, including measures of the free-flow of vehicles on the road
 - 34.2. outcomes linked to service performance, such as safe travel, the performance of key interchanges, environmental performance, workplace safety (both during construction and operation) and customer satisfaction.
35. The NZ Transport Agency may also make provision for other payments where the contractor can provide additional assistance to achieving the government's broader goals for the transport network.

Payment Mechanism

36. The NZ Transport Agency has selected an availability-based payment mechanism rather than a demand risk transfer regime. This is due to the relatively low traffic forecasts for the route and the current unattractiveness to the market of demand risk transfer models. The risk pricing from the market that would be attributed to a demand risk transfer model would not provide value for money for the government.

Market sounding

37. Based on initial discussions with prospective contractors and debt and equity providers, the NZ Transport Agency reports:
 - 37.1. there is strong interest in the market for the project
 - 37.2. there is sufficient liquidity in New Zealand debt markets to support two committed-finance bids for Transmission Gully, and at least three if international bidders bring in other banks.

The use of tolling to offset construction costs

38. The NZ Transport Agency is proposing to use tolling, in accordance with the provisions of the Land Transport Management Act, as a means of offsetting the costs of constructing Transmission Gully. Tolling is expected to have a similar impact on the level of demand as it has had for the Northern Gateway Toll Road, which has a thirty percent divergence rate away from the tolled route.
39. This decision can be made separately to proceeding with Public Private Partnership procurement. The NZ Transport Agency will develop the proposed approach for tolling Transmission Gully during 2013. The Minister of Transport will consult with Cabinet in exercising his responsibilities under the Land Transport Management Act 2003.

Procurement timetable

40. The next steps in the procurement process are set out below:

- | | |
|--------------------------|--|
| November 2012 | • Invitation for Registrations of Interest |
| January 2013 | • Commence the Expression of Interest process |
| March 2013 | • Select a shortlist of consortia to progress to the Request for Proposal phase |
| December 2013 | • Select the preferred bidder |
| To mid-2014 | • Negotiation of the contractual terms with the preferred bidder
• Cabinet briefed, final borrowing approval is given
• Contract awarded |
| Mid- to late 2014 | • Construction of the project commences |
| 2019/20 | • Construction is completed, operation commences
• NZ Transport Agency begins making payments |
| 2045 | • End of contractual term |

Risks in undertaking a Public Private Partnership

41. Specific project risks will be the responsibility of the NZ Transport Agency. The following table summarises the key risks for government.

Risk	Mitigation
The NZ Transport Agency is unable to obtain a suitable bid which provides value for money.	The Public Private Partnership would not proceed and the project would be procured conventionally.
There is significant public opposition to the use of Public Private Partnerships for transport projects.	Ministerial and NZ Transport Agency communications on the Transmission Gully project will be designed to address public concerns about Public Private Partnerships.
The NZ Transport Agency's procurement process is not robust.	External quality assurance of the process is provided through the State Services Commission's Gateway process. Ministry of Transport and Treasury officials will remain involved as the process proceeds and will update Ministers as necessary.

[REDACTED]

[REDACTED]

[REDACTED]

Withheld under section 9(2)(f)(iv)

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED]

Consultation

45. The Treasury and the NZ Transport Agency were consulted in the preparation of this paper. The Department of the Prime Minister and Cabinet was informed.
46. This paper was considered by the Officials' Committee on Economic Growth and Infrastructure on 12 November 2012.

Financial implications

47. Under a Public Private Partnership, the NZ Transport Agency would make regular payments to the contractor over the period of the contract. As noted above, payments would only commence when the road is available, which is expected to be some time in 2019/20.
48. There are some short term costs (up to \$40 million) associated with the NZ Transport Agency securing the requisite properties and managing the procurement process, which would need to be met through the National Land Transport Fund. These costs have been provided for in National Land Transport Fund expenditure forecasts.
49. The actual costs, and the resulting financial liability, for the Transmission Gully project will not be known with certainty until financial close in mid-2014. However, the total level of debt is expected to peak at around \$1.32 billion in 2019/20, on an actual cost basis, before regular payments of between \$125 million to \$130 million per annum commence. This represents around three percent of expected National Land Transport Fund revenue over the 25 year payment period.
50. No changes to appropriations are required. The NZ Transport Agency will manage the payment commitments through the National Land Transport Fund and, potentially, through any revenue from tolls. [REDACTED]

Implications for Crown debt

51. A Public Private Partnership contract gives rise to a financial liability, which must be treated as a debt on both the NZ Transport Agency's books and, by extension, the government's.
52. As a Crown Entity, debt carried by the NZ Transport Agency is not core Crown debt and therefore does not impact on progress towards the government's debt objective, which is currently specified in terms of net core Crown debt. However, the debt does contribute to total Crown debt and as such impacts on the Crown's balance sheet and its reported net worth. The financial liability on the NZ Transport Agency's books will likely be considered as Crown debt by ratings agencies.

Transmission Gully project peak debt in 2019/20	Projected total Crown gross debt in 2019/20 (including Transmission Gully project)	Projected Net Core Crown Debt (debt target measure) in 2019/20
\$1.32 billion	\$113.7 billion	\$63.9 billion
0.4% of GDP	37.4% of GDP	21.0% of GDP

53. The table above shows the relative impact of the additional debt (at peak), compared to projected total Crown debt (of which the Public Private Partnership will be a part), and Net Core Crown Debt (the debt target indicator). This shows that, on its own, the impact of the additional borrowing is unlikely to be material in terms of credit rating impact. However, if Ministers were to consider Public Private Partnerships for other large transport projects, the cumulative effect of such borrowing could have a negative impact on New Zealand's credit rating.
54. In this case, we think the procurement benefits for the project and NZ Transport Agency outweigh the debt issues.

Human rights, Legislative implications, Regulatory Impact Analysis, Gender implications, Disability perspective

55. There are no implications arising from this paper.

Publicity

56. Should Cabinet agree to the recommendations in this paper, we intend to issue a media release announcing the Government has given its approval for the NZ Transport Agency to deliver Transmission Gully through a Public Private Partnership, subject to the outcomes of the procurement process.

Recommendations

57. The Minister of Finance and the Minister of Transport recommend that the Cabinet Economic Growth and Infrastructure Committee:

National Land Transport Fund: Future Funding

1. **note** that Cabinet has invited the Minister of Transport to report back on a proposed package for addressing the funding issues for the National Land Transport Fund, including an evaluation of Public Private Partnerships as an alternative delivery model [EGI Min (12) 17/4]
2. **note** that a separate Cabinet paper, "National Land Transport Fund: Future Funding" proposes a package of fuel excise duty and equivalent road user charges increases to address short-term funding issues for the National Land Transport Fund

NZ Transport Agency decisions

3. **note** that the NZ Transport Agency has prepared a Detailed Business Case which has found that there is a value for money case for procuring the Transmission Gully project through a Public Private Partnership
4. **note** that on 28 September 2012 the Board of the NZ Transport Agency approved the construction of the Transmission Gully project, as part of the Wellington Northern Corridor Road of National Significance
5. **note** that the Board of the NZ Transport Agency has proposed the use of a Public Private Partnership approach to procure the Transmission Gully project, subject to joint Ministers' approval for it to borrow

Approval of Transmission Gully Public Private Partnership

6. **note** that Cabinet Office Circular CO (10) 2 requires Cabinet approval of all Public Private Partnerships proposals by Crown agents, including the NZ Transport Agency
7. **note** that the Transmission Gully project offers sufficient scope for innovation, efficiencies and enhanced risk management to potentially provide value for money through Public Private Partnership procurement
8. **agree** that the NZ Transport Agency may pursue procurement of the Transmission Gully project through a Public Private Partnership
9. **note** that the Minister of Finance and the Minister of Transport must give the NZ Transport Agency approval to borrow for the purposes of Public Private Partnership procurement under section 160(1)(b) of the Crown Entities Act 2004
10. **note** that the estimated cost of the Public Sector Comparator Withheld under section 9(2)(j)
[REDACTED]

11. **note** that the maximum level of debt for the project is expected to be \$1.32 billion (on an actual cost basis) in 2019/20, before payments commence
12. **agree** that the NZ Transport Agency may borrow up to the estimated cost of the Public Sector Comparator as part of the Public Private Partnership
13. **agree** that the Minister of Finance and the Minister of Transport will report back to Cabinet prior to contractual close to confirm the value for money proposition and the borrowing limit under section 160(1)(b) of the Crown Entities Act 2004
14. **note** that the NZ Transport Agency will meet the Public Private Partnership payments through the National Land Transport Fund
15. **note** that the NZ Transport Agency is developing a proposal to use tolling to offset the costs of the project
16. **note** that the Minister of Finance and the Minister of Transport will issue a media release, subject to Cabinet's agreement to recommendations 8 and 12 above

Future Public Private Partnerships in transport

17. **note** that the NZ Transport Agency is evaluating the potential for Public Private Partnership procurement of other future projects
18. **note** that Cabinet will be asked to assess any further proposals on a case-by-case basis.

Hon Bill English
Minister of Finance

Dated: _____

Hon Gerry Brownlee
Minister of Transport

Dated: _____